No. 2524.

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

IDAHO-OREGON LIGHT AND POWER COMPANY, IDAHO RAILWAY, LIGHT & POWER COMPANY and O. G. F. MARKHUS, as Receiver of Idaho Railway, Light & Power Company,

Appellants,

vs.

STATE BANK OF CHICAGO, BANKERS TRUST COMPANY, F. N. B. CLOSE, A. W. PRIEST, WILLIAM H. FORSTER, H. D. MILES, EDWARD J. MULLER, GEORGE E. FISHER, W. D. WILLARD, Personally and as a Bondholders' Committee, W. J. FERRIS, as Receiver of Idaho-Oregon Light & Power Company, UNITED STATES OF AMERICA, IDAHO POWER & LIGHT COMPANY, GENERAL ELECTRIC COMPANY, WESTINGHOUSE ELECTRIC & MANUFACTURING COMPANY, A. H. SUNDLES and AMERICAN STEEL & WIRE COMPANY,

Appellees;

A. W. PRIEST, W. D. WILLARD, WM. H. FORSTER, H. D. MILES, EDWARD J. MULLER, GEORGE E. FISHER, D. M. LORD, JOHN R. ALLEN, W. O. CARRIER, ALLEN HOLLIS, CHARLES L. PARMELEE and CHARLES M. SMITH, Intervenors, and being a Protective Committee for the Holders of the First and Refunding Bonds of the Idaho-Oregon Light & Power Company,

Cross-Appellants,

vs.

IDAHO RAILWAY, LIGHT & POWER COMPANY, O. G. F. MARKHUS, Receiver of IDAHO RAILWAY, LIGHT & POWER COMPANY, IDAHO-OREGON LIGHT & POWER COMPANY and W. J. FERRIS, Its Receiver, BANKERS TRUST COMPANY, F. N. B. CLOSE, UNITED STATES OF AMERICA, IDAHO POWER & LIGHT COMPANY, GENERAL ELECTRIC COMPANY, WESTINGHOUSE ELECTRIC AND MANUFACTURING COMPANY, A. H. SUNDLES and AMERICAN STEEL & WIRE COMPANY,

Cross-Appellees.

Brief of Eldon Bisbee as *Amicus Curiae* in Support of Appellants.

Upon Appeal From the United States District Court for the District of Idaho, Southern Division.

C. G. BURGOYNE, 72 to 78 Spring Street, New York.

Filed
FEB 15 1915

Note—As the writer of this brief has taken no part in arranging the assignments or specifications of error, and as he assumes that his brief will be considered by the Court, as supplemental to that of the solicitor of record for the appellants, he has not included therein Specifications of Error, nor has he made his points referable to any particular Assignments of Error, having assumed that the Court accepts his brief as an addition to the general discussion rather than one intended to be controlled by the requirements of the Rules with respect to the contents and arrangement of briefs of counsel. Obviously, however, all of the Points are covered by Assignments of Error.

United States Circuit Court of Appeals

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United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

IDAHO-OREGON LIGHT & POWER COMPANY ET AL, Appellants, vs. STATE BANK OF CHICAGO ET AL., Respondents.	

BRIEF IN SUPPORT OF THE APPELLANTS.

SUBMITTED BY ELDON BISBEE AS AMICUS CURIÆ.

The author of this brief represents those who have supplied approximately $6,500,000 to finance the investment represented by the securities of the Idaho Railway, Light & Power Company (hereinafter called the Railway Company), including the interests of that Company in the Idaho-Oregon Light & Power Company. He did not, however, represent them at the time of the transactions of which complaint is made and seeks, therefore, to approach with unbiased judgment the consideration of the questions involved on this appeal. His desire is to discuss those questions in their broadest and most fundamental aspects, and without regard to any technical considerations.

Succinctly stated, the effect of the decree below is that holders of corporate bonds, secured by a particular mortgage, may, after the insolvency of the mortgagor and because of the

then determined insufficiency of the security, repudiate contracts between the mortgagor and a third person, made and executed respectively fifteen months and approximately one year prior to the appointment of a Receiver for the mortgagor, no complaint with respect to which has been made by the mortgagor or by its stockholders. The result is sought to be justified because as a result of the transactions additional bonds, certified and issued in exact compliance with the terms of the mortgage, increased the aggregate of the bonds outstanding and, therefore, decreased the proportionate security of those previously issued. This result was reached notwithstanding the fact that it is conceded that the very large additions to the value of the security held for the benefit of the First Mortgage Bondholders, which, under the terms of the mortgage, entitled the mortgagor to issue the additional bonds, represented the proceeds of the sale of Second Mortgage Bonds and, to some extent, the investment of surplus earnings. In the Court below, the intervenors cited no case sustaining the propositions for which they contend, but rested their claims upon what they termed a broad appeal to the conscience of a Court of Equity.

So far as we were able to judge, in the last analysis, they found their superior equities in the assertion of the fact that, despite the full performance of their contract with the mortgagor, the bondholders represented by them are entitled to greater consideration from the mortgagor than their contract required and their investment has a higher claim upon a a Court of conscience than that of others.

The brief for the intervenors in the Court below contained assertions of fact, cunningly designed to influence the Court against those whose interests are ultimately affected by the decision, regardless of the circumstance that the record contained no evidence of such facts, contained unfounded assertions with respect to evidence in the record and, so far as legal authority is concerned, presented it in the form of extracts from the utterances of courts, general in their nature, and sufficiently apt in themselves, but wholly foreign to the facts in the present case. The result is that the Court has based its ultimate conclusion upon assumptions which we believe to be entirely unsupported by the evidence. These will be discussed in subsequent portions of the brief and the

subject is mentioned now only for the purpose of placing this Court on its guard against the acceptance of the assertion of facts unless verified from the record.

As many of the propositions are considered in the brief for the Receiver of the Railway Company and as our discussion is designed only to cover points deemed fundamental, we believe that we can best aid this Court by following in a general way the opinion of the learned Judge of the District Court and pointing out wherein we consider that he has fallen into error, both with respect to the law and the facts.

I.

The Nature of the Issue.

As indicated in his opinion (Record, pp. 133, 134), in reaching his conclusions, the Trial Judge ignored the manner in which the issues were actually raised and upon the assumption that it would be to the interest of all parties to have the questions determined in advance of the foreclosure sale, considered the issues as though they had been presented by the Railway Company in connection with proof of ownership of its bonds for the purpose of sharing in the distribution of the proceeds of the sale. Although, prior to the rendering of the decision, the appellants appear to have taken no position which justified the assumption that they desired the issues to be determined other than as made upon the pleadings, in deference to the desire of the Court to dispose of the question in substance and regardless of the form of the controversy, in connection with the entry of the decree, they stipulated that they would not object to the decree upon the ground that it was made in anticipation of distribution. It is most earnestly submitted, however, that such stipulation should not be made the basis of shifting any burden of proof assumed by the intervenors in adopting their present method of procedure nor of any inferences against the appellants because of their failure to present facts which, had they assumed the affirma-

tive, they might properly have been required to present. In other words, it is clear from the stipulation as recited in the decree that its intent was to eliminate from this controversy the technical contention that the issues herein determined were prematurely tendered by the intervenors and that it was not intended thereby to deprive he Railway Company of its right to present upon distribution any facts which may be material to the conclusion reached by the Court and which are not found in this record. Any other construction of the stipulation would be subversive of the rights of the Railway Company because, upon the trial, the issues made by the Bill in Intervention and the answers of the Power Company and the Railway Company to so much thereof as the Court required them to answer, did not present the question of the rights of the Railway Company upon distribution and, accordingly, except to the extent of objecting to the decree herein upon the ground that the proceeding was prematurely brought, the rights of the Railway Company upon distribution should not be curtailed.

II.

The assumed insolvency of the Idaho-Oregon Light & Power Company was not a fact.

In this connection, we have observed that at certain points of his discussion, counsel for the Receiver of the Railway Company, argumentatively, concedes the inability of the Power Company to continue its business under the conditions obtaining during the Fall of 1912; and that, in the same way, at one part of his brief, assumes its then insolvency. As the issue of insolvency was not presented by the pleadings and was not litigated at the trial, we understand that such statements are not intended as concessions of the fact of insolvency nor of the fact that those then in control of the Company's affairs had any intention of discontinuing its business. In

any event, however, we most earnestly submit that such statements should not be accepted to the prejudice of the real parties in interest; and that, in considering the case, this Court should be guided solely by the pleadings and the evidence, regardless of the interpretation thereof by counsel either for the Railway Company's Receiver or for the Intervenors.

As we read the opinion of the learned Trial Judge, his conclusions are predicated solely upon the theory that the mortgagor Company was insolvent in September, 1912, when occurred the first of the transactions of which the intervenors complain. It follows, therefore, that if it be shown that the record contains no evidence justifying such an assumption, the entire foundation for the conclusions of the lower Court fails and the structure erected thereon must fall to the ground.

As indicative of the Court's conclusions in that regard, we call attention to the statement in the opinion (Record, p. 133) that "The Power Company has also answered, but in view of *its insolvency* and its subserviency to the Railway Company, its position in the controversy is without importance;" to the statement (p. 137) that in September, 1912, "It is clear that they (those alleged to have been representing the Railway Company) had reached the conclusion that the Power Company was hopelessly insolvent, as was undoubtedly the case, etc."; to the suggestion (p. 140), that the Railway Company interests then considered that the Power Company's First Mortgage Bonds "were worth less than their face" and, therefore, that the Consolidated and Second Mortgage Bonds were "wholly valueless"; to the statement (p. 140) that "There is but one rational explanation of the agreement, and that is that the interests having control of the Railway Company, and through it of the Power Company, having concluded that the latter was hopelessly insolvent, and that a reorganization was inevitable and a receivership probable, resorted to this expedient for saving to themselves as much of the wreckage as possible," and to the observation (p. 145) that, while it may be conceded that a creditor of a solvent corporation, whether secured or unsecured, has no legal right to complain of the improvident disposition of its property, "it must not be forgotten that here the corporation was insolvent, and those whose duties as

Trustees it was fairly and honestly to administer its affairs undertook to prefer themselves."

It will be observed that, in connection with none of the statements just quoted, has the Court referred to a *single fact* upon which to predicate his conclusion of insolvency in September, 1912.

There is no evidence in the case that the Railway Company or any one associated with it ever sold or sought to sell one dollar of the securities of the Power Company or of the Railway Company. Evidence introduced by the Intervenors, however, discloses (p. 335) that at the end of January, 1912, a few of the First Mortgage bonds sold at par, in April a few sold above par; that (pp. 340 & 344) *in September, 1912*, said bonds sold in the market at par; that as late as December, 1912, they sold at par, and that in July, 1912, *Messrs. Kissel, Kinnicutt & Company, who were the Managers of the New York Syndicate against which the Court's strictures are particularly directed, purchased $10,000 of the bonds in the market at 95½.* (p344)

The tables shown on pages 333–340 and on pages 343 & 344 indicate the general market prices of the bonds since 1910. Surely, the circumstance that those tables disclose sales as low as 80 cannot be the basis for the Court's conclusion that if the First Mortgage Bonds were worth less than their face value the Second Mortgage bonds were wholly without value, nor does it seem possible that the Court can have concluded that, because the market value of the First Mortgage bonds was less than par, the Company was necessarily insolvent. We say this, because, under such a rule, the majority of going concerns whose bonds are customarily quoted on the exchanges are insolvent. Yet, unless the conclusion of insolvency was based upon the evidence mentioned, we are unable to discover any justification therefor.

The state of the record is such that the conclusion must be invitable that the cause was not tried upon either side upon the theory that in September or December, 1912, the Power Company was insolvent but rather, so far as the Intervenors were concerned, upon the theory that, in arranging the exchange of the First for the Second Mortgage bonds, the Railway Company committed a fraud upon the holders of the

First Mortgage bonds which were outstanding prior to September, 1912, the purpose of which was to acquire a security having a demonstrated market value, varying, as shown by the tables last mentioned, during the year 1912, from 95 to par, for a security of less value, and, on the part of the Railway Company, upon the theory that, ~~since the Power Company was, at the time, a going concern which the parties in interest had every intention of maintaining as such~~, as the holders of the First Mortgage bonds had, when the additional bonds were issued, obtained all of the additional security required by their contract, no cause for complaint then existed on their part, and that the transaction must be determined with respect to conditions which existed at the time and not with respect to conditions which existed at the time of the trial. So obviously is this the case that, if this Court shall conclude that the issues here presented depend for their correct solution upon the intent of the Railway Company, in September and in December, 1912, to maintain the Power Company as a going concern, a monstrous wrong will have been done those interested in the Railway Company who participated in the challenged transactions, if they shall not be afforded further opportunity to meet that charge. As significant of their intentions in this regard, do any facts in the record suggest a reason why Messrs. Kissel, Kinnicut & Company should, in July, 1912, have been willing to pay 95½ in the market for the First Mortgage Bonds and, two months latter, be sponsors ~~of~~ in a transaction having in contemplation the confessed insolvency of the Power Company and its reorganization; and the record is absolutely devoid of evidence showing or tending to show any circumstances transpiring between July and September, 1912, which changed the attitude of Kissel, Kinnicutt & Company from that which led them to pay 95½ for the First Mortgage Bonds to one which had determined that the business would not be further prosecuted.

Insolvency is usually defined as the inability to pay one's obligations as they mature in the usual course of business. It is not dependent upon the ability to sell one's assets at a particular date for sufficient to pay his then liabilities.

Indeed, as applied to corporations, for the purpose of de-

termining whether or not the Company is insolvent within the rule that, only in such event, are its creditors interested in the disposition which it makes of its property, as we shall subsequently show, though the managers of a corporation know that its assets are insufficient to meet its obligations, unless at the time of a given transaction, it has been determined that the Company's business cannot be continued, it is not insolvent, for the purpose of applying that rule.

> *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S., 312.
> *Clark & Marshall on Private Corporations*, Sec. 787*c*.
> *Coler v. Allen*, 114 Fed. (C. C. A., 9th Cir.), 609.
> *Damarin v. Huron Iron Co.*, 47 Ohio State, 581.
> *Chick v. Fuller*, 114 Fed. (C. C. A., 7th Cir.), 22.
> *Abrams v. Manhattan Consumers Brewing Company*, 142 N. Y. Appellate Division, 392.
> *Willmott v. London Celluloid Co.*, L. R., 34 Chancery Division, 147.

As some of the authorities above mentioned are, perhaps, more pertinent to the point as to the character of frauds which affect creditors, we reserve for that place their more detailed consideration. We will, however, in connection with other authorities to be noticed, discuss some of them under this point.

Of course, the question to be determined is not the insolvency of the Power Company at the time of the trial, but in September and December, 1912.

In determining the validity of a voluntary conveyance, the insolvency of the grantor at the time of the conveyance is the question to be answered; its subsequent insolvency is of no importance.

> *State v. Martin*, 77 Conn., 142.
> *Masters v. Templeton*, 92 Ind., 447.
> *Philips v. Potter*, 32 Iowa, 589.
> *American National Bank v. Thornburrow*, 109 Mo. App., 639.
> *Martin v. Evans*, 2 Rich. Eq. (S. C.), 368.
> *Bank v. Puget Sound Loan, etc., Co.*, 20 Wash., 636.

And the fact that one is insolvent when the bill is filed is no evidence of insolvency at the time of the transaction.

> *Windhaus v. Bootz*, 92 Cal., 617.
> *Coghill v. Boring*, 15 Cal., 213.
> *Seaman v. Bisbee*, 163 Ill., 91 ; 45 N. E., 208.
> *Donahue v. Coleman*, 49 Conn., 464, 466.
> *Nevers v. Hack*, 138 Ind., 260 ; 37 N. E., 791.
> *Hathaway v. Brown*, 18 Minn., 414.

It is our sincere belief that, in making the statement in his opinion concerning the insolvency of the Power Company, the learned Trial Judge was sub-consciously affected by the circumstance that both the Power Company and the Railway Company subsequently became insolvent ; that he had been called upon to appoint receivers thereof and that such receiverships were still pending in his Court. So strongly does he appear to have been affected by the conditions subsequently surrounding him that, although counsel for the Receiver was willing to concede, for the purpose of developing all of the questions possibly involved, that the property will not bring sufficient to pay all of the outstanding first mortgage bonds, without a scintilla of evidence in the record upon which to base the statement, he observes in his opinion that, "It is wholly improbable that the proceeds (of a sale of the Power Company's property) will be sufficient to pay in full the First Mortgage Bonds outstanding, *aside from those presently involved*." Undoubtedly, he was influenced to make the observation because of the obvious fact that, unless and until a sale has demonstrated the insufficiency of the security to pay all of the outstanding First Mortgage Bonds, no possible damage can be suffered by the Intervenors ; for which reason also he desired to dispose of the issues as though the sale had been made and a deficiency had resulted.

As we have before mentioned, the issues were neither made nor tried by the Intervenors upon the theory that the Power Company was insolvent, but upon the theory of the Bill in Intervention, which was that, in September and December, 1912, the Power Company was a very valuable property, which was then the victim of an extravagant management ; and that, because those interested in the Railway

Company had, with the exception of the Power Company, ill-advisedly made their very large investment in the Companies and properties controlled or acquired by the Railway Company in September, 1912, they began the consummation of a conspiracy, which dated from September, 1911, when the Bankers first purchased an interest in the Power Company, to acquire the property of the Power Company for nothing, to which end they so manipulated the affairs of the Power Company that in April, 1913, they deliberately brought about a fictitious default with respect to its First Mortgage Bonds. That such is a scheme of the Intervenors Bill is abundantly shown by statements contained in Clauses VII., VIII., IX., X. (pp. 14-29), XI., XII., XIII., XIV., XV., XVI., XVII. (pp. 28–37), and XIX. (p. 39), to which we earnestly call the Court's attention.

Thus, the petition alleges (Clause VII., pp. 14–15) that the bankers had purchased $6,500,000 of the Railway Company's bonds " with a view of re-selling the same to the public," but that " said bonds have not in fact been sold to the public " because " they have not been marketable for the reasons hereinafter set forth " ; that being unable to market the bonds, the bankers pledged them with various financial institutions in New York City ; that such bonds were not marketable because the earnings of the properties acquired by the Railway Company were insufficient to meet operating charges, adequate provision for depreciation and " interest upon the excessive and exorbitant prices paid for said properties and for which said $6,500,000 of bonds were issued."

" The intervenors show that Kissel, Kinnicutt & Company (the Bankers) and their associated banks have now *been carrying this load* for nearly two years, and that it became clearly necessary to consummate the plan of acquiring the property of the Power Company in such a manner as to get additional security behind the said bonds of the Railway Company and especially to show added earning capacity in order to render the said Railway bonds marketable and avoid an enormous loss on the $6,500,000 of such bonds ; and the readily available course was to get rid of the First Mortgage Bonds of the Power Company by the easy device of a foreclosure, at which there would be and could be no bidder except the Railway Company, and thus seize the property and earnings of the Power Company "

(p. 17) ; that monies which are alleged to have been required by the original contract between the Power Company and the Bankers to be used for certain purposes were " diverted to other purposes to the great injury of the Power Company and its creditors ; and the Intervenors charge that this was done in pursuance of a scheme of the Railway Company and Kissel, Kinnicutt & Company *to reduce and divert the income of the Power Company, break down its credit, cause it to default in its obligations and to purchase its property for a nominal amount, to the fraud and injury of the holders of the First Mortgage Bonds of the Power Company* " (p. 19) ; " the control and domination of the Railway Company over the Power Company is thus shown *to have been destructive of its business and income, an attack upon the security and bonds held by your Intervenors,* and your Intervenors charge that this control and domination were *exercised for the purpose of depreciating such security and enabling the Railway Company to carry out the scheme of purchasing the Power Company's property on the proposed reorganization,* which is shown in the plan attached to the Bill of Complaint herein and *of which the default in interest alleged in the Bill and this suit to foreclose are a part* " (pp. 19, 20), " that the Intervenors charge that *the obtaining of the control of the Power Company by the Railway Company was the beginning of a plan then formed for the absorption of the business and properties of the Power Company without just and true compensation therefor,* of which *the management of* the Power Company by the Railway Company, *the alleged defaults* in the payment of interest on the Power Company's bonds in April, 1913, the plan of reorganization prepared and put out in advance of said default, the foreclosure herein instituted, are all a part, etc. " (p. 36), that, " although the Power Company *refused* payment upon the interest coupon on the First Mortgage Bonds which was due April 1, 1913, and thereby occasioned default thereon, such failure *and refusal was due to the domination and control of the Railway Company and was part of the scheme for the acquisition of the property of the Power Company by the Railway Company* through this foreclosure ; and that, immediately thereafter and before the declaration of default by the Trustee, said *interest was in fact paid to the bondholders* who are said to seek this foreclosure, and paid in part by the Trustee which is a complainant herein * * * and that, therefore,

although a formal and technical default was created, no actual default now exists as to any of the bonds deposited with the New York Committee, etc. etc."

Such quotations from the Bill might be multiplied indefinitely.

After the hearing upon the petition for leave to file the same the Power Company and the Railway Company were required to answer only with respect to the portions of the Bill referring to the 718 bonds, the 107 bonds and the allegations with respect to the actual payment of interest to certain of the First Mortgage Bondholders. The order also provided that, "the failure of any party to answer any averments in said Bill in Intervention not expressly required by this order to be answered shall not be construed as an implied admission that the same are true" (pp. 56 and 57). In accordance with the order the answers filed were limited to the matters particularly set forth therein. That circumstance did not, however, to any extent, restrict the activities of counsel for the Intervenors, as is, to some extent, shown by the testimony offered and excluded (pp. 454–477). That the Intervenors did not assert nor seek to prove that the Power Company was insolvent in September and December, 1912, is evident in many ways. Thus (pp. 203–204), monthly reports of operations of the Railway Company were offered, as stated by counsel, "for the purpose of showing the *condition of the Railway Company* in 1912, as establishing a motive, or tending to establish a motive, for the transaction which is in issue here, etc.," and which was admitted over the objection of the respondents, the Court expressing its conclusion in the following language: "This is somewhat remote, but I think perhaps I shall let it go in. It may have some bearing upon the good faith and reasonableness of the transaction. The objection will be overruled." The Exhibit will be found at pages 205–206. Its receipt in evidence was followed by the offer by Intervenors' counsel and the receipt, over the objection of respondents' counsel, of testimony to the effect that, on December 31, 1912, which was the month covered by the statement of operations, the "capital charges outstanding against the Railway Company were $7,361,000. Most of it at 5%" (p. 207). Then by the balance sheet of the Railway Company as of December 31, 1912

A.

The intervenors presented much evidence to show that, had the Directors so desired they might have sold the First Mortgage Bonds at advantageous prices, which effort is wholly inconsistent with the assumption by the Learned Trial Judge that the Company was then "utterly insolvent". Thus, (p.319) in response to inquiries from intervenors ~~xxxxxx~~ counsel, Mr. William Mainland stated that, in his opinion, in the Fall of 1912 the first mortgage five percent bonds then subject to certification could have beensold at a fair price to produce the funds needed by the Company. Mr. Sinclair Mainland made a similar statement (p.321), saying that he urged that such action be taken but that "from his conversation with Mr. Fuller he was of the opinion that the latter did not want to do it". Intervenors counsel asked Mr. Reynolds, one of his bond selling witnesses, the same question; and he replied that, from the condition of the company as it appeared from its statements, reports and information, he could have marketed the five percent bonds on the same basis as the six percent, which would be about 82 (p.341). On Page 343, this witness again made a similar statement. Mr. Parmelee, another bond selling witness stated that "considering what was publicly known of the affairs of the Power Company in the latter half of 1912", he thought that the five percent bonds could then have been sold at a fair price (p.345); and that he then thought they were worth par (p.346).

$16,330,000.

Whatever may have been the intent of counsel in introducing the Exhibits above mentioned and others which accompanied them, it is most earnestly contended that the consideration of certain items appearing thereon demonstrate beyond peradventure that those in control of the Power Company in September and December, 1912, had no expectation that its business was to be discontinued.

The statement of earnings of the Power Company for September, Intervenors' Exhibit 25 (p. 213) shows (last line) that during that month *$69,637.55 had been expended, for construction alone,* while intervenors' Exhibit 29 (p. 216) shows that, during September of that year the Property, Plant and Equipment *had increased* (second line of the Exhibit) *to the extent of* $79,637.55.

Intervenors' Exhibit 30 (pp. 220, 221), shows (last line) total construction for 1912...........	$385,359.12
The corresponding statement for the nine months ending September 30th (Exhibit 28, p. 213) was	267,463.71
Accordingly, *during the three months ending December 31, 1912, total expenditures for construction alone aggregated*............................	$117,895.41

These Exhibits also show that, *dnring December, 1912, the Company expended for construction no less than $79,923.55.*

Turning to the general balance sheet as of December 31, 1912 (Exhibit 33, pp. 225–229), we find :

Total additions to Property, Plant and Equipment during 1912..............................	$680,539.70
By comparison with Exhibit 31 (p. 222) we find that at September 30, 1912, the total of such additions was................................	470,359.12
Showing that *during the three months ending December 31, 1912, additions to Property, Plant and Equipment were made to the extent of*........	$210,180.58

It will be observed that the sum last mentioned is greater than the estimate of the general manager for the four months ending December 31, 1912 (pp. 426–429).

Having due regard for these figures, introduced, as will be recalled, by the Intervenors, is it possible to conclude that

intelligent business men would, in addition to making up the deficit in current earnings, have expended these large sums in extending the Plant and Equipment of this Company had they anticipated that it would shortly cease to be a going concern? Could there be more persuasive evidence of the intentions of the parties in September, 1912, when occurred the first of the transactions which the Trial Court has condemned on the ground that the Power Company was then insolvent? Do men of affairs add to an already large investment in an enterprise at the rate of $70,000 per month, *after* they have concluded that it is an utter failure and that it cannot be made a success? Surely it is sufficiently serious to have considered the Railway directors scoundrels, whereas, if the Court is correct as to their intentions, they must also be branded as fools.

The record contains no evidence with respect to the additions to the plant and property after December 31, 1912. It is most confidently contended, however, that, if a determining factor here is the question as to whether or not, in September, 1912, the Directors of the Power Company had concluded that its business could not be continued and had concluded that it would shortly cease, for which reason, as the lower Court considers, they were actuated by the motive of saving as much of the wreckage as possible, the officers and directors of the Railway Company should be afforded full opportunity to spread upon the record their acts from the first date in question, until the appointment of the Receiver *in December, 1913*. We conceive it to be improper to make assertions with respect to facts which are not in the record. We feel, however, that it is abundantly fit and proper that we should appeal as strongly as possible to the conscience of the Court in order that the transactions of individuals, heretofore bearing honorable personal and business reputations, may not be finally condemned as fraudulent, because of their knowledge of the insolvency of this corporation, when they were not, either by the Intervenors' pleadings or by any suggestion during the conduct of the trial, called upon to defend themselves against such a charge.

In addition to the foregoing, as bearing upon this point, we call attention to the fact (pp. 402–404) that, at the end of November, 1912, the Power Company entered into a contract

with Bates & Rogers Construction Company, calling for the payment by the Power Company of $40,000 in cash, in order that it be released from a burdensome contract and that, in the same contract, they agree to pay in cash (p. 403) other sums for a portion of the plant of the Bates & Rogers Company, depending on an appraisal, and took an option on another portion of their plant at a price of $12,000.

Would this settlement have been made and consummated at that time, if these people had been intent upon wrecking the Power Company ; or had they the slightest notion that a Receiver of its properties was likely to be appointed ? Had any such expectation been present, would they have paid out large sums of money in cash for the purpose of being rid of a contract, which, as the testimony abundantly shows, they desired to terminate, because their engineer had advised them that continued construction thereunder would increase the cost of the work to the extent of $100,000 ? If any notion of Receivership had then been in their minds, a much more economical method of disposing of the contract would have presented itself.

In addition to the foregoing considerations, the Court will notice that a part of the complaint of the intervenors was with respect to the certification and disposition by the Power Company of 107 of the First Mortgage Bonds, in addition to the 718, which bonds were certified after April 1, 1913, and that even at that late date, and after default in the payment of interest on the First Mortgage Bonds, the Railway Company loaned money to the Power Company upon the security of the 107 bonds (pp. 109 & 134).

Taking the assets and liabilities of the Power Company, as disclosed in the balance sheet of September 30, 1912, which is the only direct evidence before the court as to the character of the items which may properly be considered upon the credit and debit sides of its account, we find that the total assets are listed at $15,537,000, while, eliminating the $10,-000,000 of capital stock, we find the liabilities listed at $5,-537,000, thus showing a surplus of more than $5,000,000 (Ex.

31, pp. 222–224). The same aggregates as shown on the balance sheet as of December 31, 1912 (Ex. 33, pp. 227–229) give a surplus of $5,885,000. On the basis of these figures, therefore, at the end of each of the months in question, the value of the company's assets exceeded that of its liabilities.

The only evidence to offset the valuations thus shown is the concession (p. 381), made at the trial by counsel for the respondents that, for the purpose of this case, the respondents were content to have the court assume that the value of the company's properties were then *(in June, 1914)* less than the aggregate of the first mortgage bonds, which aggregate, as shown by the record, is, including the 107 bonds, $3,319,000. Assuming the accuracy of the concession which, in view of the existing foreclosure decree, was undoubtedly made with the idea of values such as would likely be established upon a forced sale under financial and commercial conditions then existing, can it be reasonably and convincingly argued that the valuations shown in the balance sheet were necessarily erroneous? During the interval, it is a matter of common knowledge, that corporate properties which, prior to the recent severe business depression, were believed to possess very great value, have realized at forced sale prices representing but a small proportion of the values which they had justifiably been considered to possess under more promising conditions.

We have reserved for another place the discussion of the general proposition as to what corporate transactions creditors are entitled to assail, and the conditions under which their claims may be asserted. We assume, however, that everyone will agree that, unless, at the time of the transactions complained of, the corporation be insolvent, the interests of creditors are not affected; and the point which we particularly wish to make here is that the character of insolvency contemplated by this rule is not necessarily measured by a surplus in selling value of assets over liabilities, nor necessarily by the ability of the corporation to meet its obligations as they mature in the usual course of business, but by the consideration as to whether or not, at the time of the transactions under investigation, it is still prosecuting its business in good faith with a reasonable prospect and expectancy of continuing so to do.

The rule is stated in Clarke & Marshall on Private Corporations, section 787*c*, and is expressed in the following language:

> " By the weight of authority, a corporation is not insolvent, *within the meaning of the rule prohibiting preferences by insolvent corporations to their officers,* merely because it is embarrassed *and cannot pay its debts as they become due,* or even because its assets, if sold, would not bring enough to pay all its liabilities, *if it is still prosecuting its business in good faith with a reasonable prospect and expectation of continuing to do so.*"

Tested by this rule, we most confidently assert that the record here under review not only contains not a scintilla of evidence suggesting that, in September, 1912, and in December, 1912, those responsible for the conduct of the affairs of the Power Company did not expect that its business would continue, and, in good faith, did not consider that the reasonable prospect justified such a conclusion.

In Corey v. Wadsworth, 99 Ala., 68, the court held that to render a corporation insolvent,—

> " it is not enough that its assets are insufficient to meet all its liabilities, if it be still prosecuting its line of business, with a prospect and expectation of continuing to do so. In other words, if it be, in good faith, what is sometimes called a *going* business or establishment. Many successful corporate enterprises, it is believed, have passed through crises, when their property and effects, if brought to present sale, would not have discharged all of their liabilities in full."

In Walkenshaw v. Perzel, 4 Robertson (27 N. Y. Super.), 426, the court remarked that,—

> " it is true that '*insolvency*' and '*inability to pay*' are synonymous, but insolvency does not mean inability to pay at all times, under all conditions, and everywhere on demand, nor does it require that a person should

> have in his possession the amount of money necessary to pay all claims against him. *Difficulty in paying particular demands is not insolvency.*"

In Queen v. Saddlers Co., 10 H. of L. Cas., 404, it appeared that a by-law of a chartered company provided,—

> " that no person who has become a bankrupt, *or otherwise insolvent,* shall hereafter be admitted a member of the Court of Assistants of this company."

The relator was elected a member of the court, but at the time was not possessed of sufficient assets to meet all of his liabilities, although he then continued in business without default. Shortly thereafter, however, he was declared a bankrupt. *Held,* that within the meaning of the by-law, he would not be regarded as insolvent at the time of his election.

In the opinion in French v. Andrews, 81 Hun (New York), 272 (affd., 145 N. Y., 441), in considering a statute prohibiting the transfer of assets by insolvent corporations, the court thus stated its conclusions :

> " Insolvency has been differently defined in different courts. By some it is said to be a condition in which the value of the assets is less than the amount of liabilities. By others it is said to be a general inability to pay obligations as they become due in the regular course of business. Many a business is at times insolvent according to the first of these uses of the word, although it is prosperous, and no one thinks for a moment that any necessity will arise for applying its property to the payment of its liabilities by process of law. There is no necessity for the law to interfere in behalf of the creditors so long as the corporation is able to meet its obligations promptly. The use of the word, in the statute under consideration, is the latter use."

In Toof v. Martin, 13 Wall., 40, speaking through Mr. Justice Field, concerning insolvency under the former Bankruptcy

Act, which did not define it, the Supreme Court of the United States said:

> "The term insolvency is not always used in the same sense. It is sometimes used to denote the insufficiency of the en ire property and assets of an individual to pay his debts. This is its general and popular meaning. But it is also used in a more restricted sense to express the inability of a party to pay his debts as they become due in the ordinary course of business. *It is in this latter sense* that the term is used when traders and merchants are said to be insolvent, and as applied to them it is the sense intended by the act of congress."

In this connection it is interesting to observe that the case which appeared to the learned Trial Court to contain language "most pertinent," and from which he quoted extensively in support of his conclusions, is Howe, Brown & Co. v. Sanford Fork & Tool Co., 44 Fed., 231 (Record, pp. 147, 148). This case was reviewed by the Supreme Court of the United States in 157 U. S., 312, and the judgment below was *unanimously reversed*. In the light of the conclusions reached by the higher court, as the learned judge below stated, the case is "most pertinent" to this phase of the present controversy, for which reason we will consider it at some length.

There, the plaintiffs were creditors of the defendant Company, whose claims accrued prior to March 17, 1890, at which time the mortgage complained of was executed. The individual defendants included all of the directors of the Company. Between September 18, 1889 and March 3, 1890, such directors endorsed notes for the defendant Company aggregating $74,000.

"At the time these directors and stockholders endorsed these notes, the Tool Company was a going concern, in full operation, etc. * * * They believed that such property was worth what it had cost in cash, that the corporation was 'solvent and capable of becoming an independent and profitable manufacturing institution as soon as it could win its way to a favorable market for its manufactured products.'"

As the notes began to mature, it was found that the Com-

pany could not pay them and required a renewal or an extension. Thereupon, on March 1, 1890, at a meeting of stockholders, at which 2250, out of a total of 3,000 shares, were represented, the directors were authorized to execute a mortgage upon all of the Company's property to secure any new indebtedness that might be incurred, " or the renewal and extension of any present indebtedness or liability of the corporation." Thereupon the mortgage in controversy was executed, conveying the Company's manufacturing plant to a trustee to indemnify the six endorsers of its said notes, five of whom constituted its board of directors. The mortgage was not recorded until May 1, 1890. When it was executed, the Company was in full operation as a "going concern," and, in fact, the corporation continued to be "a going concern" and carried on its business in the usual way, and met all its obligations (other than the notes embraced in the indemnity mortgage) as they matured in the usual course of business, until the appointment of a Receiver *on May 13, 1890*. The directors accepted the mortgage in good faith, with knowledge that all of the money obtained from the notes which they had endorsed had been properly appropriated to and gone into the property and material of the Company.

At the time of the execution of the mortgage, the Tool Company was indebted in the sum of $275,000; the value of its property at that time does not appear, but after the appointment of a Receiver it was appraised, the manufacturing plant (the property described in the mortgage) at $116,000; its other and unincumbered property at $88,000.

As the stockholders meeting, which authorized the mortgage, was held on March 15, 1890, although the date of the mortgage is not given, it must have been executed on or after that date. As the Receiver was appointed May 13, 1890, it will be observed that the Company confessed insolvency within less than two months after the giving of the mortgage.

Mr. Justice Brewer, in delivering the opinion of the Court, among other things, said:

> "The corporation was still a going concern. There was no purpose of abandoning the business. The indorsers believed that if the corporation could be tided over its temporary embarassment it could be made suc-

cessful. * * * Thus they (the directors) prevented a suspension of the business and enabled the corporation to continue its operations, and did so believing that by such continuance the corporation would be able to work itself out of its temporary difficulties. All this was done in the utmost good faith.

" Under these circumstances, should the transaction be condemned and the mortgage held void as against creditors ? This question, we think, must be answered in the negative."

The learned Judge then considered the relationship of the stockholders and of the corporation to the matter, and observed :

" It was an application by the debtor of its property to secure certain of its creditors and not the act of the agents of a debtor to protect themselves. The case involves no breach of trust on the part of the agent towards the principal, but more closely resembles the case of an individual debtor giving preferences to certain of his friends, and the general rule is that, in the absence of statute, a debtor has such *jus dispondi* in respect to his property that, although insolvent and contemplating a cessation of business and the surrender of his property to his creditors, he may lawfully prefer certain of them, even though thereby others receive no payment.

" But, passing from the relations of directors to the corporation and its stockholders, it is one of the vexed questions of the law as to how far the duty of a corporation and its directors to creditors interferes with the otherwise conceded powers of a debtor to prefer certain of his creditors."

After stating that, because of the circumstances of the case, it was unnecessary to go into a discussion of that question in all of its phases, and after pointing out that the case was not similar to others cited where the " directors of a corporation, insolvent and intending to discontinue its business, gave a mortgage to secure certain of their number who hap-

pened to be creditors, and thus intended to secure a preference in behalf of themselves," proceeded :

> " * * * here the corporation was a going concern and intending to continue in business, and the mortgage was given with a view of enabling it to so continue, and to prevent creditors whose debts were maturing from invoking the aid of the courts to put a stop thereto. Can it be that, if at any given time in the history of a corporation engaged in business, the market value of its property is in fact less than the amount of its indebtedness, the directors, no matter what they believe as to such value, or what their expectations as to the success of the business, act at their own peril in taking to themselves indemnity for the further use of their credit in behalf of the corporation? Is it a duty resting upon them to immediately stop business and close up the affairs of the corporation? Surely, a doctrine like that would stand in the way of the development of almost any new enterprise. It is a familiar fact that in the early days of any manufacturing establishment, and before its business has become fully developed, the value of the plant is less than the amount of money which it has cost, and if the directors cannot indemnify themselves for the continued use of their personal credit for the benefit of the corporation, many such enterprises must stop in their very beginning."

The Court also points out as a significant circumstance that the Company continued business for two months after the mortgage was given, during which time it paid out in the usual course of its business and in the discharge of obligations, more than $30,000, " without appropriating a single dollar to the payment of the claims for the endorsement of which they had taken this indemnity." Thereupon, the opinion closes, as follows :

> " We are of opinion * * * that it is going too far to hold that a corporation may not give a mortgage

> to its directors who have loaned their credit to it, to induce a continuance of the loan of that credit, and obtain renewals of maturing paper at a time when the corporation, though not in fact possessed of assets equal to its indebtedness, is a going concern, and is intending and expecting to continue in business."

We have referred to the foregoing case at length, both because the learned Trial Judge largely rested his conclusions upon the case as reported below and upon Lippincott v. Shaw Carriage Co., 25 Fed., 577, which was similar to the Howe, Brown & Co. case, and was decided by the same Judge, and because it indicates clearly the line of distinction between the cases which are condemned as being in fraud of creditors, because of insolvency of the corporate debtor, and those which are not subject to condemnation.

Although, in the case at bar, because the issue was not presented by the bill, the Railway Company interests have not been afforded an opportunity to show affirmatively that they did not consider the Power Company insolvent in September or December, 1912, in the sense that they knew that its business could not be continued and understood that it would not be; nor that, in advancing it additional funds and lending its credit, it was with the hope and expectation that its then financial difficulties would be overcome, we most confidently assert, however, that upon the record as it stands, the Court can find no justification whatsoever for its conclusion that the Company was considered by its directors to be insolvent, within the rule stated, and that they had concluded or expected that its business would shortly be discontinued.

In view of the evidence to which we have called the court's attention, and particularly in view of the lack of evidence justifying a finding of insolvency in September and in December, 1912, with great respect for the learned trial judge we most earnestly revert to our previous explanation of his unwarranted and uncalled for conclusion "that the Power Company was insolvent and known and considered so to be by its directors" in September, 1912, namely, that sub-consciously he was affected by the conditions which had obtained since his appointment in December, 1912, of receivers for both the

Power Company and the Railway Company, and that, instead of addressing his mind solely to conditions shown by the record to have existed in September and in December, 1912, he found it impossible to rid himself of the conditions with which, for many months, he had then been struggling. The probable correctness of this conclusion is emphasized by the fact that, in reaching that conclusion, he departed entirely from the theory upon which the Intervenors formulated and tried their case, and rested his decision upon a finding in respect to which the respondents were afforded no opportunity to present evidence.

Since his decision was based wholly upon the assumed affirmative fact of insolvency, we most earnestly submit that, if the assumption were unwarranted, his conclusions have failed to suggest any theory upon which the Intervenors are entitled to relief and that, accordingly, his decree must be reversed and the Intervenors' bill be dismissed.

III.

The circumstances which justify creditors in assailing corporate acts.

It is interesting to observe that the industry of counsel for the Intervenors was not rewarded by the discovery of a single case holding that bondholders, situated as are the intervenors, have ever been accorded the right to question the acts of their corporate debtor in disposing of its property, unless, by such acts, their contract has been breached. Accordingly, none of the cases cited by the learned trial court pretend to touch that point.

The general rule is that,

> " the legal relations between a creditor and a corporation are occasioned either by contract binding on the latter, or by a tort, for which it is responsible. Before the claims of a creditor arise, and during the transac-

tion itself on which his claims are based, the creditor is simply an outsider towards whom the corporation, or the corporate agent with whom the creditor contracts, *owes no duty not due to members of the public at large.* And creditors will rarely have any standing in court to object to acts of the corporation done before their claims arise."

Taylor on Corporations, 5th Ed., Sec. 651.
Graham v. R. R. Co., 102 U. S., 148.

In the case last cited it was alleged that lands were conveyed by the corporation to one N for an inadequate consideration; that N purchased with funds furnished by the directors, and soon afterwards conveyed to them personally. *Held* that, so long as it was not alleged nor shown that the corporation was insolvent, nor *that the conveyance was made with intent to defraud creditors*, as long as the company did not complain, creditors whose claims were not shown to have existed at the time, could not.

See, also:

Porter v. Pittsburgh Steel Co., 120 U. S., 649.
Continental Trust Co. v. Toledo R. R. Co., 82 Fed., 642, at p. 655.
Toledo R. R. Co. v. Continental Trust Co., 95 Fed., 497, at p. 528.
Central Trust Co. v. Columbus Ry. Co., 87 Fed., 815, at p. 828
Central Trust Co. v. Worcester Cycle Co., 110 Fed., 491.
Anderson v. Bullock, 122 Ala., 275.
Wells v. Northern Trust Co., 195 Ill., 288.
Beach v. Wakefield, 107 Iowa, 567.
Commercial Bank v. Warthen, 119 Ga., 990.

The authorities last cited abundantly sustain the proposition that, regardless of the character of his claim, unless a creditor was such at the time of the transactions of which complaint is made, there is no right under which he can contest them. This point is also clearly brought out in McLean v. Eastman, 21 Hun, at p. 315, where the court says:

"It is not alleged in the complaint, nor does the scope of the action permit an inquiry as to whether the

creditors represented by the assignee were creditors at the time of the transaction; and, if not, *they have no interest in the money sought to be recovered.*"

To the same effect are:

Billings v. Robison, 94 N. Y., at p. 419.
Morawetz on Corps., 2nd Ed., Sec. 868, foot p. 841.

The court will search the record in vain for the purpose of determining when any of the Intervenors acquired their bonds. The only evidence on the point is the allegation contained in the Bill in Intervention (clause III., p. 7), which alleges that at the time of the preparation thereof (September 16, 1913, p. 47) they held bonds of the aggregate face amount of $432,000; and the stipulation contained in the record to the effect that, at the time of the trial, they held bonds of the aggregate face value of about $2,000,000. Obviously, therefore, certain of their bonds were acquired between the date of the filing of their bill and the time of the trial of the action, but the record is silent as to when they, or those whom they represent, first acquired their bonds. Tested by this elementary and fundamental rule, therefore, the Intervenors have not shown themselves to be in a position which, from any standpoint, justifies criticism on their part, or on the part of any of them, of the acts under review.

"A corporation cannot confer a right or claim against property which it does not own. Equitable claims of creditors can, therefore, attach only upon such assets as *belonged to the corporation* at the creation of the indebtedness or are acquired by the company thereafter. Hence, if a corporation should incur debts and become insolvent, after a portion of its capital stock has been withdrawn or *diverted from corporate uses*, creditors would not be entitled to follow the property or fund previously transferred, and hold it subject to their equitable lien, as in case of a distribution of assets made by a corporation while insolvent, and at the expense of existing creditors. Under these circumstances, creditors could not claim to have been wronged by

transfer of property made by the company while entirely solvent and before their claims arose."

Morawetz on Corps., 2nd Ed., Sec. 800.
Graham v. R. R. Co., 102 U. S., 148.

It thus appears clearly that unless in September and in December, 1912, the Power Company was insolvent within the rule established by the authorities heretofore cited, ~~we believe that we have abundantly shown that~~, under no possible circumstances, does the door of a court of equity open to the Intervenors in order that they may criticise the alleged wrongful acts.

The rights of corporate creditors as distinguished from the rights of the corporation and its stockholders to complain of transactions between the company and its directors was carefully considered in O'Conner Mining Co. v. Coosa Furnace Co., 95 Ala., 614, where the principles involved are so clearly and ably expounded that we quote therefrom at some length :

> " But the duty which disqualifies the directors from binding the corporation by a transaction in which they have an adverse interest, *is one owing to the corporation which they represent, and to the stockholders thereof.* A principal may consent to be bound by a contract made for him by an agent who, at the same time, represented an interest adverse to that of the principal. A *cestui que trust* may elect to confirm a transaction which he could have repudiated on the ground that the trustee had an interest in the matter not consistent with his trust relation. In like manner, *dealings between corporations, represented by the same persons as directors, may be accepted as binding by each corporation and the stockholders thereof.* The general rule is, that such dealings are not absolutely void, but are voidable at the election of the respective corporations or of the stockholders thereof. They become binding, *if acquiesced in by the corporations and their stockholders.* * * *
>
> " The directors of the corporation, in the transaction of its business and the disposition of its property, do not stand in any such relation to the general credit-

> ors of the corporation as they occupy to the corporation itself and to its stockholders. They are not the agents of such creditors, *nor can they usually be regarded as trustees acting in their behalf. The creditors are not entitled to disaffirm a transfer of the property of the corporation, made by its directors or other agents, merely because the corporation itself or its stockholders could have done so.* When a disposition of the property of a corporation is assailed by its creditors, *they are not clothed with the right of the corporation or of its stockholders to set aside the transaction, regardless of its fairness or unfairness,* on the ground that it was entered into by representatives of the corporation who had put themselves in a relation antagonistic to the interests of their principal. *The right of the creditor to impeach the transaction depends upon its fraudulent character.* The question in such case is, *was the transaction which is complained of entered into with the intent to hinder, delay or defraud creditors?*"

It is impossible for us to perceive, and no authority or principle has been brought to our attention suggesting, any reason why bondholders or other secured creditors should be more favorably situated in this regard than the general creditors. Indeed, in considering abstract equities, it would appear that, so long as the provisions of their contracts are fully performed, because of the possession of security courts should be less rather than more solicitous in their behalf.

In view of the rules of law last mentioned, it will be interesting to consider the cases, other than Howe, Brown, Co. v. Sanford Fork & Tool Co., relied upon by the learned trial court as sustaining his views.

The first cited is Jackson v. Ludeling, 88 U. S., 616. The facts there were that certain minority bondholders, who were directors of the mortgagor company, had procured an order for the sale of its property which, without notice to the other bondholders or to the mortgage trustee, which they had purchased for $50,000 and had, by what the court found to be "unwise and illegal conditions of sale" which "were exacted from other bidders but not from these purchasers" deprived the company of a bid of $550,000 for the property.

The facts of the case were found by the court *to constitute deliberate fraud upon the majority bondholders and to have deprived them of the benefit of their contract.* Accordingly, the court granted relief at the instance of the majority bondholders and, in so doing, used the language quoted in the opinion of the trial judge.

The next case cited by the Trial Court is Wabash Central & Pacific Ry Co. v. Ham, 114 U. S., 587. That action was brought to assert in a broad aspect the proposition that the property of a corporation is a trust fund for the benefit of its creditors, which, as we shall subsequently show, is not a rule of property, but only one of convenience, developed by courts of equity in administering the estates of insolvent corporations. The observations of Mr. Justice STRONG, quoted by the learned trial Judge, are wholly general, and have no application to facts such as those under consideration here. Indeed, in that case, the court held that the trust fund theory did not entitle the plaintiff to relief.

The Court next quoted from Lippincott v. Shaw Carriage Co., 25 Fed., 577. This case was decided by Mr. Justice WOODS, who subsequently decided the Howe, Brown Co. v. Sanford Fork & Tool Co. case, which, we have noticed, was reversed by the Supreme Court of the United States. The general observations of the learned judge in the Lippincott case were quite similar to those in the Howe, Brown & Co. case.

Whatever may be said of its reasoning, as applied to the facts there under review, it was found, as a fact, that the corporation, *while insolvent,* had transferred assets to its directors and managing agents under such conditions that they, as creditors, had thereby *acquired a preference* over the plaintiff, also a creditor at the time.

The court next cites Sweeney v. Refining Co., 4 S. E. (West Va), 431. This also was an action by creditors, which was consolidated with one brought by mechanics' lienors, to set aside *conveyances of all of the property* of the defendant corporation to a trustee to secure debts due another corporation, which was a creditor and which had common directors with the Refining Company, whose votes were necessary for the authorization of the deeds. The court found that the defendant company *was wholly insolvent* at the time of the transac-

tion ; *that it was known so to be by the directors ;* that no present consideration was given for the deeds, that they constituted a *fraudulent preference,* and were intended to have that effect. In other words, they were made with intent to hinder, delay and defraud existing creditors, among whom were the plaintiffs.

Although the court does not quote therefrom, it also cited Richardson v. Greene, 133 U. S., 30, which was much exploited by intervenors in the court below as being practically upon all fours so far as the position of the plaintiff and the intervenors are concerned. A careful reading of the case, however, disposes of any such possibility. The court's decision affects only, in one feature, 400, and in another 1105 of the bonds, which are mentioned in the opinion. These 400 bonds were *obtained without any consideration whatever,* and were taken by Richardson while treasurer and when the Company's other officers considered that they were only in his possession for safe keeping. Later Richardson obtained a judgment against the company for a small sum, upon which execution was issued. Thereupon he surrendered to the sheriff the 1105 bonds and numerous other bonds held by him as treasurer, had them sold under the execution, and himself became the purchaser, at a nominal price. As to the last transaction, the court held, first, that by delivering them to the sheriff and permitting them to be sold as the company's property Richardson waived any claim of lien upon the bonds ; and, second, as they had never been issued within the terms of the mortgage, they were not subject to attachment or to execution as valid obligations of the company.

This case is most instructive, and its consideration discloses that, despite the gross frauds practised by Richardson, the court protected him in the claim to the bonds delivered as security for the monies actually loaned.

IV.

(a) Fraud which entitles creditors to assail corporate acts.

(b) None such is here shown.

"Contracts between a director and his company are not nullities, but are merely voidable in equity *at the option of the corporation.* The contract is not void unless confirmed, *but is binding unless disaffirmed.* Hence, *such contracts cannot be avoided by anybody except the company.* * * * We have already seen that such contracts cannot be avoided by a minority shareholder. So, too, a sale of corporate property to the directors cannot be treated as a nullity, *or annulled by individual creditors of the corporation.* * * *

"The law governing the attempts by directors of a concern on the point of insolvency to secure a preference for their own claims against the company relates to the subject of winding up and dissolution, and is hardly pertinent here. Suffice it to say that preference of that sort may, on principle it would seem, be avoided by the receiver or liquidator without resort to any 'trust fund' theory or to any bankruptcy law invalidating the fraudulent preference, upon the simple principle that all dealings between the corporation and its directors are *voidable by the company or its receivers.* Indeed, it would seem that such preference may be set aside by individual creditors without resorting to any 'trust fund' theory or bankrupt act, upon the ground that such preferences *are fraudulent at common law or under the Statute of Elizabeth.*"

Machen, Modern Law of Corporations, Sec. 1594.

The creditor "can assail the act (of a corporation) only on the ground that its intent or *effect is to fraudulently divert the credit or assets from his debt: he must charge fraud.*"

Thompson on Corporations, Sec. 2850.

It is also to be observed that, in the absence of an intent to defraud a particular creditor and in the absence of statu-

tory restrictions, a corporation has the same right as an individual to prefer creditors.

Coats v. Donnell, 94 N. Y., 168.

The Statute of Elizabeth, mentioned by Machen, is the original statute in England, forbidding a debtor to transfer his assets with intent to hinder, delay or defraud his creditors. Its substance has been enacted in various forms in this country, and we assume that such statutes exist in the State of Maine, the domicile of origin of the Power Company, in Idaho, where the corporate business was transacted, and in New York, where the particular proceedings in question were had and the contracts made.

Although general and rather broad, perhaps a fair statement of the rule which entitles a creditor to act is the following:

> " Whenever a creditor *has a vested right in or a lien upon the property*, the enforcement of which is hindered or rendered inadequate *by a fraudulent conveyance or encumbrance*, he may maintain a suit in equity to remove it, without showing an execution or return of it unsatisfied, or without exhausting his other legal remedies."
>
> *Schofield v. Ute Coal & Coke Co.*, 92 Fed., 269, at p. 271.

The case is very exceptional, however, which entitles to relief a creditor whose claim has not been reduced to judgment.

Scott v. Neely, 140 U. S., 108.
Maxwell v. McDaniels, 184 Fed., 311.

The latter case applies the rule last stated, notwithstanding the conceded insolvency of the debtor.

It would seem, therefore, that the strongest position which under the facts of this record, we can assume the Intervenors to occupy, is that they were creditors of the Power Company in September and December, 1912; that their claims are secured by the mortgage under foreclosure; that the Power Company is now insolvent and that, because their claims are conceded and, because, for the purpose of this proceeding, it

has been assumed that the properties of the Power Company will sell for less than the face amount of all of the First Mortgage Bonds outstanding, including those held by the Railway Company, their rights will be determined as though the sale had already been had, a deficiency had resulted, and they had become judgment creditors through the entry of a deficiency judgment; in other words, that they are judgment creditors.

Let us consider then, the character of the fraud which would entitle them to attack a transfer of the Company's property. For the purposes of this discussion, we assume the transactions to have resulted in a transfer of corporate property.

In his learned work on Fraudulent Conveyances, dealing with the Statute of Elizabeth and, by analogy, with similar statutes in this country, Mr. Bigelow (Knowlton's Revised Edition, 1911, p. 82), says :

> " When we come to conveyances *made for valuable consideration* a different question, *applicable alike to existing and future creditors*, arises. Such conveyances, if made in good faith, are expressly excepted from the operation of the statute. When is a conveyance not made in good faith ? Is it necessary that it should be made *with actual intent to defraud*, to take it out of the exception ? *So it appears to have been laid down.* ' There is one class of cases, no doubt,' it has been said by way of concession, ' in which *an actual and express intention is necessary to be proved*, that is, where the instruments sought to be set aside were founded on valuable consideration.' "

In this connection, it is pertinent to observe that, as the author last quoted also points out, while a debtor continues to have dominion over his property, and in virtue of such dominion he " may do many things, with the sanction of law, which may possibly or probably or even certainly delay or defeat his creditors. He may prefer his creditors ; he may sell, mortgage, assign, or otherwise dispose of his property as though he were not a debtor."

Bigelow, p. 448.

It is further pointed out that, "apart from special statute, the law does not deprive a debtor, even upon becoming insolvent, of his power to dispose of his property" (*Id.*, p. 450). Again: "To the simple, or at least lawful act of dominion *something wrongful* must be added to bring the case within the operation of the statutes; *there must be a trust* or a reservation out of the property for the debtor, or there must be an unlawful provision of some sort affecting the rights of creditors;—or, to come directly to the intent class of cases under the third aspect of intent, the transaction, if 'naturally' or legally 'innocent,' as by being on its face an ordinary exercise of dominion, must be a *subterfuge*" (*id.*, p. 450).

> "Where harm follows from doing only what everyone may lawfully do, the case cannot, in any view, be treated as *intended wrong-doing.*
>
> "In one particular this power of dominion, under the law allows a debtor to go a step further. He may not only prefer one creditor to another; *he may do so with the express personal intention of defeating the other creditor or creditors*, so far as the Statute of Elizabeth and the like American statutes are concerned. *Something further must be added* to make a case of intent to defraud within the meaning of those statutes" (*id.*, pp. 452 & 453).

In order that fraud of the character under consideration shall exist, it must be shown that the actors in the transaction had in mind, or to state the matter as favorably as possible to the Intervenors, should have had in mind the relationships of the Intervenors to the corporation; that they intended what was done to be in derogation of their rights and that the Railway Company should illicitly obtain an advantage. Thus, *the mere circumstance* that, as between the corporation and the actors, the consideration given by the corporation was grossly in excess of the value of what it received, *is of no importance. Stewart v. St. Louis F. S. & W. R. Co.*, 41 Fed., 736. The facts there were that two individuals had purchased a roadbed of a cost value of only $2,000; that they caused a Railroad Company to be organized,

of which, with others, they became directors, and while in such relationship, contracted to sell said roadbed to the Company for $200,000 in cash or bonds and $3,600,000 capital stock. As bonds were not available, the Company issued its notes for $200,000 in performance of the contract. The transaction had been approved by the directors and by the stockholders. Suit was brought to recover on $85,000 of the notes, and the Company sought to defend on the ground that, because of the fiduciary relationship between those who transferred the $2,000 roadbed and the corporation, the transaction should be condemned and payment of the notes excused. Discussing this matter the Court says :

> " The question still remains, were they guilty of fraud, deception, or any other breach of good faith in their fiduciary relations as directors ? * * * When the sale to the company was made they did hold a position of trust, and were bound in their official action to faithfully and honestly execute their duties and not to make a deal where their personal interest should be served at the expense of the Company they represented (citing). But it does not follow that the directors are prohibited, under all circumstances, from dealing with a member or members of the board as individuals. But there must have been a fair and open deal. It must have been free from fraud or collusion and characterized by entire good faith (citing). It does not appear in this case that there was any deception or fraud practiced by the parties. The property was open to inspection, and the approximate cost of constructing it was easily obtainable. Its value to the company for the purpose desired was not difficult to ascertain. * * * Now, who was defrauded or deceived ? All parties—directors and stockholders—assented to it ; and, surely, subsequent purchasers of stock, or the corporation itself cannot now object to it."

Applying the language of the foregoing opinion, who was defrauded in the case at bar ? Intervenors show that the

Railway Company held at least eighty per cent. of the stock of the Power Company and the Company does not complain.

One of the cases mentioned in the opinion of the Trial Judge (Wabash, etc., Ry. v. Ham) was, apparently, cited to the proposition that corporate property constitutes a trust fund for creditors. Accordingly, we append controlling authority that, whatever else may be its scope, such doctrine is inapplicable, except in cases of confessed insolvency.

In *Hollins v. Brierfield Coal & Iron Company*, 150 U. S., 371, it is held that

> "Neither the insolvency of a corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together give a simple contract creditor of the corporation any lien on its property, *or charge any direct trust thereon.*"

Again:

> "*When a corporation becomes insolvent*, the equitable interest of the stockholders in the property, and their conditional liability to creditors, places the property in a condition of trust, first for creditors, and then for stockholders; but this is rather *a trust in the administration of the assets after possession by a Court of Equity*, than a trust attaching to the property, as such, *for the benefit of either creditor or stockholder.*"

In the last-mentioned case, the Court also quoted with approval from the opinion of Mr. Justice BRADLEY in *Graham v. Railroad Co.*, 102 U. S., 148, as follows:

> "When a corporation *becomes insolvent*, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A Court of Equity, at the instance of the proper parties, will *then make those funds trust funds*, which, *in other circumstances, are as much the absolute property of the corporation as any man's property is his.*"

To the same effect are *Wabash, etc., Ry. v. Ham,* 114 U. S., 587, p. 594, cited by the Judge below, and Fogg v. Blair, 133 U. S., 534, at p. 541. In the latter, the Court said:

> "We do not question the general doctrine invoked by the appellant, that the property of a railroad company is a trust fund for the payment of its debts, but do not perceive any place for its application here. That doctrine only means that the property must first be appropriated to the payment of the debts of the company before any portion of it can be distributed to the stockholders; *it does not mean that the property is so affected by the indebtedness of the company that it cannot be sold, transferred, or mortgaged to bona fide purchasers for a valuable consideration, except subject to the liability of being appropriated to pay that indebtedness. Such a doctrine has no existence.*"

In *Lawrence v. Greenup,* 97 Fed., 906 (C. C. A., 6th Cir.), it was held that a receiver of a bank could not recover from a stockholder a sum received by him on a partial distribution of the assets of the bank, made during voluntary liquidation when the bank was solvent, though it subsequently became insolvent. The receiver contended that he should recover on the theory that the assets of the bank were a "trust fund" for creditors. The Court in an unanimous opinion delivered by LURTON, J., said: "Under the decisions of the courts of the United States, *there is no solid foundation* for the contention that *the capital of a corporation which is solvent is a 'trust fund'* upon which there is any lien for the payment of corporate debts. The property of a solvent corporation *is as much the absolute property of the corporation as is the property of an individual.* Neither a corporation nor an individual *can so exercise the power of disposition* over that which is possessed *as to fraudulently defeat the just demands of creditors.* But neither the individual nor the corporation can be said, in any accurate sense, *to hold his or its property subject to any trust in favor of creditors. When, however, the insolvency* of a corporation is established, a condition arises which authorizes a court of equity, in view of the conditional liability of the assets to creditors and the equitable rights of stockholders, to

treat the property as ' in a condition of trust, first for the creditors, and then for the stockholders.' "

The present situation well illustrates the difficulties which always result from the failure to observe orderly procedure. Although the Bill in Intervention is very lengthy and elaborate and practically charges the directors of the Railway Company and of the Power Company with a conspiracy to acquire for the Railway Company without adequate consideration, the property of the Power Company, the order based thereon (pages 55 to 59) merely permitted the filing of the bill " subject to the limitations hereinafter explained." Thereupon it denied the motion for leave to file a proposed answer to the foreclosure bill, but provided that " the same shall be placed in the custody of the Clerk of the Court for preservation as a part of the record upon the hearing." The order then provided that " the intervention is expressly made subordinate to said decree (of foreclosure), and such averments in said Bill in Intervention as serve only as the basis of the Intervenor's contention that the decree should be vacated and set aside, shall be treated as surplusage, and ignored in the further proceedings of the case."

Manifestly, it is difficult to determine accurately the averments which properly serve as such a basis and those which do not. Whatever else may be said with respect to the order, it would seem from the language last quoted that the court necessarily decided that the Power Company had suffered default, as alleged in the foreclosure bill ; that such default had not been fraudulently procured by those in control of its affairs and that, accordingly, all allegations of the bill to the effect that fraud had been practiced upon the Power Company for the purpose of and with the result that it thereby became unable to pay its interest charges, were overruled.

The order then requires the Power Company to " answer all of the allegations in said bill in intervention relating to the 718 bonds, aggregating $718,000 par value, secured by the First and Refunding Mortgage, upon which foreclosure is sought here ; " that the Railway Company be made a party to the proceeding for the purpose of answering the allegations of the bill " respecting the 718 bonds ; " that the complainant (the Trustee under the First Mortgage) and the Power Company answer the allegations of the bill " as to

the matter and manner of the payment of interest due April 1, 1913, under the mortgage herein foreclosed to a portion of the holders of the bonds secured by said mortgage," and that "the failure of any party to answer any averments of said bill in intervention not expressly required by this order to be answered shall not be construed as an implied admission that the same are true."

Clearly, it is practically impossible to determine from such an order the precise allegations of the bill to which answers were required, while some portions thereof appear to be inconsistent with the denial of the right of the Intervenors to answer the foreclosure bill. Thus, if the Bill in Intervention truly avers that the interest due April 1, 1913, on the first mortgage bonds was not paid to certain of the bondholders but was paid to those who deposited their bonds with the so-called New York Committee, mentioned therein, such circumstance would tend to support the allegation that the pretended default in the payment of interest was fictitious, in which event no right of foreclosure resulted therefrom. This was properly a matter of defense to the foreclosure bill and, if relevant at all, the Intervenors should have been permitted to set it up by way of answer. If it were not relevant for this purpose, it is difficult to perceive upon what point it is material, yet answers thereto were required by the Power Company, the Railway Company and the Trustee under the first mortgage. Except for the purpose of illustrating the difficulty experienced by the Appellants in determining the issues to be met, the point is not now material, because it was abandoned at the trial (p. 168).

The Bill in Intervention, as printed, covers 46 pages of the record. The 718 bonds are mentioned but twice, namely, at pages 28 and 42. We will not prolong the brief by quoting the allegations with respect of them. Their substance, however, is that early in 1913 the Railway Company demanded that the Power Company receive from it second mortgage bonds and deliver in their place its first mortgage bonds; that being fully under the control and domination of the Railway Company, the Power Company necessarily acceded to the demand and delivered to the Railway Company $718,000 of its first mortgage bonds, after the Railway Company had collected in November, 1912, interest on the second mortgage

bonds ; that in view of the fact of the " alleged deficit in the earnings of the Power Company for the year 1912, and in view of the default and foreclosure then planned and anticipated," the second mortgage bonds " had no market value and were to all intents and purposes worthless, and that the said exchange of bonds was *wholly without consideration and was, as to the intervenors and the Power Company, wrongful and fraudulent*, and that the said bonds are not, because of said issue and delivery by the Power Company to the Railway Company, issued and outstanding *and valid obligations of the Power Company*, but that the same should be by this court *called in and cancelled*." And at page 42, " that there has been, as above shown, issued by several devices, bonds of the Power Company to the amount of * * * $718,000, which are alleged to be valid and outstanding obligations of the Power Company, but which in fact are not such valid and outstanding obligations, which should *be surrendered and cancelled, and if so surrendered and cancelled would thereby greatly reduce the alleged obligations* of the Power Company *and the interest charges against its income*."

As we have heretofore observed, the entire Bill, despite its length and the fact that it contains every other conceivable charge against the interests controlling the Railway Company, contains no suggestion that, at the time of the transactions with respect to the 718 bonds, the Power Company was insolvent, but alleges that, although the default in interest on the first mortgage bonds was fictitious, because " of the alleged deficit in the earnings of the Power Company for the year 1912,' and in view of such default, the second mortgage bonds were worthless, the exchange was *without consideration, and, consequently, fraudulent.*

From the order made on this bill, it would appear that the only allegations which the Railway Company and the Power Company were required to meet, were those directly concerning the 718 bonds. We make no mention of the 107 bonds, because they have substantially been removed from this issue. Relying upon this order the Railway Company and the Power Company have made answer to the specific allegations with respect to the 718 bonds contained in the bill. In so doing, they made no mention of any facts bearing upon the question of the insolvency of the Power Company, because the order

or of an intent to hinder delay and defraud the Intervenors

did not require them to do so. Notwithstanding this fact, and, as we have before observed, that the conduct of the trial by the Intervenors, far from seeking to show that the Power Company was insolvent at the time of the 718 bonds transactions, was carefully planned from the standpoint of showing that it was not insolvent, the trial court grounds its opinion upon the finding that the Power Company was insolvent at the time; was known so to be by the Railway Company interests; that the transaction was had with that end in view and for the purpose, as the learned court expresses it, of saving part of the wreckage, and thereupon rests its conclusions upon the fact that the Power Company was "hopelessly insolvent," for which reason the transactions with respect to the 718 bonds were fraudulent and should be set aside at the instance of even the intervening bondholders.

It is elementary and fundamental that a decree, to be operative for any purpose, must be *secundem allegata et probata*, in other words, that it must follow the allegations and proofs of the parties. Since the Railway Company did not know, and had no means of knowing, that the issue of insolvency was to be considered, much less to be the determining factor, if this decree is to go unchallenged, a most grievous legal wrong will have been done the Railway Company without having had its day in court.

Assuming that we have shown that, even as the record is made, within well established rules governing the question of insolvency of corporations, the Power Company was not insolvent in September or December, 1912, and since, as we have also shown, however fraudulent a transaction may be, creditors cannot complain unless the corporation be at the time insolvent, further discussion may be useless. We desire, however, so far as is possible from the record before us, to consider every phase of the controversy and will proceed, therefore, to inquire what facts or circumstances appear in the record which are significant of fraud upon the rights of these bondholders.

Much evidence was introduced by the Intervenors for the purpose of seeking to show that, when the Board of Directors considered the agreement of September 25, 1912, certain of the directors present refrained from voting, while another voted in the negative, with the result that the votes actually cast in

the affirmative were not a majority of a quorum, from which it was gravely argued below that the transaction was not binding upon the corporation. Surely, it will not require the citation of authority to this learned court to demonstrate the proposition that, whatever other rights they may have, creditors are not entitled to question the sufficiency of the authority of corporate agents to effect a given corporate transaction, when the transaction has been fully executed and neither the corporation nor its stockholders have complained. In its simple elements, the question is whether or not the officers of the corporation who acted in its behalf, and, therefore, as its agents, were sufficiently authorized by the corporation as the principal. It is as though one individual, claiming to act as the agent of another, had made a contract in that other's behalf which had been entirely performed by the principal, or by the agent with the knowledge and consent of the principal, and thereafter, without the authority of the principal, a third person assumed to question the authority of the agent. As is fully shown in the brief of the counsel for th appellants, transactions between directors and their corporation, regardless of their fairness or unfairness, may be repudiated and abrogated by the Company itself or by its stockholders or they may be ratified and approved by them; and the failure promptly to repudiate them results in acquiescence and approval; and where there is no suggestion of corporate or stockholders' disapproval, such approval must be assumed. In any event, whether approved or disapproved by the corporation or by stockholders, the transactions here under review have been completed, and intervenors bear no such relation to them as will justify an inquiry on their part as to whether or not they were properly authorized.

We do not lose sight of the fact that our claim of acquiescence and approval will be met by a statement that, since the directors and officers of the Power Company were the same as those of the Railway Company, no one could act directly for the Company in disapproval; and that since the Railway Company owned practically all of the capital stock of the Power Company, few stockholders could act indirectly in its behalf in disaffirming the transactions. The effect of this response is not to indicate that creditors have the right to raise the question of proper

corporate authority, but to disclose that those who were parties to the transactions were the only ones interested therein and that, as both stockholders and creditors, if they so desired, they were entirely within their rights in seeking to better their position in the latter regard. We refrain, therefore, from discussing further the questions relating to proper corporate authority.

~~Taking the record as we find it, it appears (page 236) that Mr. Watson, who was the Power Company's managing director, made a statement as to the financial condition of the company and recommended that $250,000 be raised to meet its requirements during the coming seven months.~~

Turning now to the testimony, it appears (p. 236) that, at the meeting of the Board of Directors, held September 25, 1912, Mr. Watson, its Managing Director, made a statement as to the Company's financial condition and recommended that $250,000 be raised to meet its requirements during the coming seven months.

In this connection, it may be well here to advert to certain observations in the opinion of the Trial Judge. Thus, although his opinion characterizes the Power Company as " utterly insolvent " at the time, when he comes to the consideration of the details of the transaction (p. 139), he says :

" The Company needed money, it is true, but if it was going on with the Ox Bow Development the sum contracted for was wholly inadequate for any useful purpose, and if the work at that point were not to be resumed, *there was no urgent need for so large an amount.* Those who participated in the transaction are unable to give any reasonable explanation of the purposes for which the $250,000 were to be used, and *apparently there is none.*"

These statements wholly ignore the testimony of Mr. Markhaus (p. 425), the then General Manager of the Power Company, and the data contained in a memorandum which he prepared about September 1, 1912, " for the purpose of showing the cash required for the operation of the Company for the last four months of 1912, which was forwarded by him to Mr. Watson, the Managing Director of the Company at New York, shortly after it was prepared and early in September, 1912." The statement will be found at pages 426–429 of the record and, after considering all cash available and

estimating all cash receipts during the four months in question (which would take the Company to the end of the then current year) specified in detail the precise construction items required to be met and demonstrated that, during such four months, the cash deficit would amount to $203,180. The Minutes of the Directors' Meeting held September 25, 1912, recite that Mr. Watson made a statement as to the financial condition of the Company and recommended that $250,000 be raised to meet the requirements of the Company "*for the next seven months*" (p. 236), which statement is wholly consistent with the estimate for four months sent to Mr. Watson by the General Manager at Boise. In testifying on this subject in November, 1913, fourteen months later, Mr. Watson stated (p. 273) that as he remembered it, they were being pressed for monies for the corporate purposes of the Company and the necessity that they had to provide money for making extensions and buying electrical apparatus, etc., to handle their business (p. 274) ; that he is certain, generally speaking, that they had a financial program that required that sum of money, but that he did not then remember it in detail ; that it was not a temporary makeshift (p. 275) ; that there was nothing definite decided about the Ox Bow ; that they did not have the money to go on with it at that time, but " we all felt that it was going to be continued at some time in the near future " (p. 276) ; *that shortly before he left the management of the Company the conclusion was first reached* that it could not go on and keep on paying interest and keep on its feet as a going concern. And Mr. Mainland, one of the witnesses called by the Intervenors, testified (p. 316) that Mr. Watson *ceased to be Managing Director of the Power Company about May 1, 1913.*

A number of the other directors of the Railway Company and of the Power Company, men of large interests and varied activities in New York, but who had no close association with the practical details of the business, were also asked by counsel for the Intervenors if they could recall in detail any of the purposes for which the $250,000 was to be used and, speaking generally, at the time when they were examined, which was in the fall of 1913, they did not recall any of the details. In view of the lapse of time, of the fact that, when the matter was considered, undoubtedly, they had before them the

written estimate prepared by the General Manager, and of the great number and character of the items appearing thereon, can it be said to be surprising that they were unable to recall it in detail and does such failure of recollection adequately justify the conclusion of the trial Court that apparently there was no reasonable explanation of the purposes for which the $250,000 were to be used? As noted, the Court appeared to be influenced by the circumstance that " there was no *urgent need* for so large an amount." Just what is comprehended within that expression, we cannot, of course, be certain. The record, shows, however, that on October first, six days following the meeting, the semi-annual interest on the First Mortgage Bonds was payable ; that on November first, the semi-annual interest on the Second Mortgage Bonds was payable, and that, within the then succeeding three months, in accordance with the estimate of the General Manager, large payments would be required in connection with construction work, extensions and power-lines then under way. The record also shows that the money was only advanced as required and that (p. 258), it was actually paid over as follows : October 4, 1912, $100,000 ; November 1, 1912, $20,000 ; December 11, 1912, $60,000 ; December 17, 1912, $40,000, and on January 3, 1913, $30,000. It also appeared that instead of $500,000 to which the Railway Company was entitled under the terms of the agreement, only $440,000 of First Mortgage Bonds were deposited as collateral for these loans (p. 258).

In all fairness, is it possible that directors must not provide several months in advance for the requirements of their Company, lest they subject themselves to a charge that, because all of the money was not, at the time when the arrangements were made, " urgently " required, they were prompted by ulterior motives ; and because, more than a year thereafter, they cannot recall the details of the Company's then requirements, especially when so complex as those here shown, is that fact to be considered significant of insincerity on their part in connection with the transaction ?

As bearing upon the necessity for the Funds and the reasons therefor, the evidence also shows that the great difference between the results of operations of the Power Company during 1912 and those of preceding years, as shown in state-

ments introduced in evidence by the Intervenors, was that, until 1912, all interest on the bonds issued in connection with the Ox Bow development had been charged to capital, and that in 1912 such interest amounted to $133,442 90 (page 436). Intervenors' Exhibits 30 and 32 (pages 221 and 226, note *a*), show that the aggregate of the bonds so issued was $2,856,846. Exhibit 32 also shows that, despite the favorable net earnings, as shown in Intervenors' Exhibit 40 (page 231), in 1911, after charging against earnings the "contingent interest" a surplus for the year remained of only $5,800. It also appears (page 435) that during the year 1912 $23,339.80, which, during 1911, had been charged to "development," was in 1912 also charged against earnings as part of the operating expenses. It further appears from Exhibit 40 that the net earnings for 1912 were $17,000 less than in 1911. Accordingly, had the net earnings for the two years been the same and had the $23,339.80 of expenses been charged against earnings in 1911 ~~instead of 1912~~, the net result of operations during the two years would not have greatly varied. The record also shows that, at a meeting of the Executive Committee of the Power Company held August 30, 1912 (page 232), the matter of raising additional funds "to take care of the extension of distributing systems and the building of transmission lines was taken up and discussed," and a resolution adopted to the effect that the general manager should prepare and submit a statement showing the expenditures that have been made by the Company "in connection with the building of transmission lines, sub-stations and distributing systems since July 1, 1910, and that the same should be forwarded to the directors for approval, for the purpose of being filed with the trustee under the mortgage, so that additional bonds may be secured for the raising of funds." This meeting was attended by Messrs. S. L. Fuller, William Mainland and R. W. Watson, as well as by the operating managers at Boise, Messrs. R. L. Bacon, H. F. Dickey and O. G. F. Markhus (p. 232). It also appears that the resolution above mentioned was offered by Mr. Watson and seconded by Mr. Mainland, who was the company's president, who had been such since its origin and, with his brother, had entirely controlled the corporation until the contract of September, 1911, was made, but who is not included by the Intervenors

among the arch-conspirators conjured up by their imaginations.

Mr. Markhus testified that, about September 1, 1912, he also prepared a statement of cash requirements of the Power Company for the purpose of showing the money that would be necessary to be raised for its operations during the last four months of 1912, which was forwarded to Mr. Watson at New York, early in that month. As we have before noticed, the statement appears at pages 426 to 429 of the record and discloses that, in addition to estimated net returns from operation during the four months, the net cash requirements would be $203,180.

It cannot, therefore, well be contended that Mr. Watson's estimate of $250,000 for the coming seven months was extravagant, in view of the general manager's estimate for the four months ending December 31 and the other circumstances to which we have called attention. At least, the transaction was open and above-board; and the record contains no impeachment of any kind of Mr. Markhus's estimate nor of the propriety of that of Mr. Watson, except the innuendoes of counsel, which seem to have been adopted by the learned Trial Court because, in November, 1913, neither Mr. Watson nor other New York directors then examined, could recall the details of the Company's requirements for which, in arranging for the $250,000, provision was intended to be made.

The record of the meeting of September 25, 1912, further shows that, after Mr. Watson had explained the Company's money requirements, a proposed agreement was presented to the meeting between Kissel, Kinnicutt & Company, the Power Company and the Messrs. Mainland, who were the parties to the agreement of September 19, 1911, whereby Kissel, Kinnicutt & Company first became interested in the Power Company's securities, which proposed agreement recited that the Bankers had purchased $1,325,000 of the second mortgage bonds, $1,500,000 of which they had agreed to purchase under the provisions of the 1911 agreement; that they were prepared to purchase the remaining bonds, which would have netted the Power Company $140,000, but were unwilling to purchase additional bonds; that the Power Company would require during the following six months $250,000, which $250,000 the bankers agreed to procure for the company in

consideration of being released from their obligation to purchase the remaining $175,000 of second mortgage; that the Bankers would procure the Railway Company to loan the Power Company the $250,000 at 6 per cent. interest, of which $100,000 was to be advanced at once and the balance, whenever requested *during the following six months*; that each loan so made *should run for a period of six months* from the date thereof, *with an option to the Power Company to renew the same for a further period of six months* at the same rate, and all were to be secured by the Power Company's first and refunding mortgage five per cent. bonds, equal at their face value to twice the amount of the loan.

The agreement also provided that, as a further consideration to the Railway Company for making the loan, the Power Company would, as the Railway Company, from time to time, requested, exchange $500,000 of its first and refunding five per cent. bonds for an equivalent face amount of the Power Company's second mortgage six per cent. bonds, which the Railway then owned. This agreement was, according to the minutes, duly authorized and, although Mr. William Mainland's recollection is that he refrained from voting on the resolution, *he executed the agreement in behalf of his firm* (pages 236 to 241).

Pausing for a moment to consider this agreement and its bearing upon the accusations of fraud, whatever else may be said of the arrangement, in what manner are the circumstances surrounding its making indicative of an intent to defraud these Intervenors? In the first place it released the Bankers from the necessity for making an additional investment of $140,000 in the second mortgage bonds. Surely this phase of the contract did not directly concern the Intervenors, and whether or not, as between the Corporation and the Bankers, it was a wise or proper transaction appears to us, therefore, to be of no moment. If, as the court concludes, the company was then insolvent, a very much simpler method of terminating the Bankers' liability would have been to place the company in the hands of a receiver. Instead of any effort in that direction, the agreement recites, and the statement is not challenged in any way, that the Bankers were prepared to complete their contract.

Had the company then been deemed to be insolvent and had they then considered, and if it were a fact, that the second mortgage bonds were worthless, it is most confidently submitted that the bankers were *ipso facto* relieved from any further obligation to purchase the remaining bonds.

> *Benedict v. Field*, 16 N. Y., 595.
> *Bruce v. Burr*, 5 Daly (N. Y. Common Pleas), 510, affirmed 67 N. Y., 237.
> *Harris v. Hanover National Bank*, 15 Fed., 786.
> *Roberts v. Fisher*, 43 N. Y., 159.
> *Ex parte Chalmers*, L. R. 8 Ch., 289.

We do not pause here to consider these authorities in detail, because we propose to discuss them at some length under a subsequent point, and the circumstance that the agreement recites that the Bankers were willing to purchase the additional bonds is mentioned now only as persuasive evidence that they did not then consider the Power Company insolvent and, accordingly, that they did not consider the second mortgage bonds worthless.

The second significant fact in this connection is that the entire $250,000 was not to be loaned at once, but was to be available at any time during the succeeding six months. It was in fact all loaned by January 3, 1913. This is significant, because, had the arrangement for the loan of the $250,000 been a mere pretence, the $100,000 advanced at once would not have been followed up by subsequent advances, and the company would not have been permitted to continue its business during the six months period. In other words, had the arrangement been a mere cloak for fraud, as small a sum as possible would have been advanced immediately, the authorized exchange of second for first mortgage bonds would have been made immediately and the company would then have been left to shift for itself, instead of which it was maintained and sustained by the Railway Campany until an impossible situation had been created by these Intervenors ; and until the cut-throat competition, actually introduced into Boise in January, 1913, had made itself felt for a period of a year, whereupon, these Intervenors having attacked the good faith of the Railway Company's efforts to so reorganize the business that it would have a chance to meet the competition and survive, the Railway Company's interests succumbed

to the inevitable (page 514), withdrew their opposition to the Intervenors' *motion for the appointment of a receiver* and such receiver was appointed.

The third significant fact in the agreement is that the loans were to be made upon notes which were to be payable six months after their respective dates, and that the Power Company was to have the right to renew each of them for a further period of six months ; and the notes given for each loan were in fact each payable six months after date (page 430). Had they been made as part of a conspiracy merely to obtain the first mortgage bonds and had the Railway Company interests then intended that the Power Company should shortly cease to transact business, is it natural to suppose that the loans would have been made upon six months' time? The advisable procedure would rather have been to make the notes payable on demand, in order that the holders might have been free to exercise their rights from day to day as they considered that circumstances required ; and the fact that they were willing that each loan should run six months and be subject to renewal for a further period of six months can, it is most confidently submitted, be considered significant only of an expectation that the company would continue in business during that time, and, indeed, that its then financial troubles might be overcome and its business prove a successful enterprise.

The learned Trial Court appears to have considered that the various steps taken are to be deemed significant of a conspiracy, because there was no good reason why the Power Company did not sell its first mortgage bonds instead of hypothecating them to the Railway Company on the basis of fifty per cent. of their face value. Assuming, however, that the parties were entirely sincere in the transaction, were not the Power Company's interests better served by pledging its bonds for long time loans than by seeking to sell them in the market at a time when, because of the first honest statement of its earnings, they were showing a deficit ?

During the trial the auditor of the Railway Company took from the books of the Power Company a statement showing the prices which the company had realized for all of its bonds, which showed that of the $2,494,000 sold others, only

80 per cent. had been realized for $1,346,000 face amount thereof and 85 per cent. for $1,076,000 face amount thereof (Exhibit G, page 437). The detailed statement of these sales (pages 439–453), discloses that, with the exception of the 718 held by the Railway Company, only $53,000 of the first mortgage five per cent. bonds have been issued ; and that they brought the following prices :

Amounts	Prices
$10,000	100
5,000	95
3,000	75
30,000	70
3,000	75

The table further shows that all of these bonds were disposed of prior to 1912 and, therefore, during a period when, by reason of the fact that interest on about $2,000,000 of the bonds issued for the Ox Bow development, was charged to construction or capital account instead of against the earnings, the company was apparently showing a considerable surplus of earnings. In view of those prices, considering the large deficit from operations, the approaching competition and other unfavorable circumstances existing in the fall of 1912, can it be reasonably supposed that the five per cent. bonds would have brought in the market more than 60 ; and, if so, from the standpoint of the company's reputation and credit, was it advisable to offer them to the market at all? Surely, there cannot be two opinions on this point, and, therefore, if the situation will be only considered from a sane and unprejudiced standpoint, it would seem most obvious that the best interests of the company required that, as between seeking to sell the five per cent. bonds and pledging them as collateral, the latter was the far wiser course.

Whatever else may be said of the further provision in the contract whereby the Railway Company was given the right to exchange Second for First Mortgage Bonds, it is there set out in so many words, no effort at concealment was made on the part of any one and, although the evidence would seem to show that Mr. Thompson, one of the directors, intended at least to be understood as voting against this provision and

that Mr. William Mainland, who presided at the meeting, failed to vote thereon, as well as Mr. Sinclair Mainland and Mr. Fuller (the two latter concededly because they considered that they were interested parties under the terms of the contract) as before observed, the contract was actually made, signed by the Vice-President of the Power Company, by Mr. William Mainland, in behalf of his firm, and by Mr. Fuller in behalf of Kissel, Kinnicutt & Company. Whatever technical effect may have resulted from the failure of the Messrs. Mainland and Mr. Fuller to vote for the purpose of making a majority of the quorum, equitably at least, their assent to the agreement, as disclosed by the signature of the Mainland firm and by Mr. Fuller's signature in behalf of his firm, would seem to remove any chance for controversy as to what was their ultimate attitude towards the transaction.

At all events, the evidence clearly shows that at least $440,000 of the First Mortgage five per cent. bonds were first deposited as collateral to the notes for $250,000, but that the exchange of the $500,000 of bonds as authorized, was not made until January 3d and January 6, 1913 (p. 259), although more than $300,000 thereof were in hand when the agreement was made, the balance having been received during December and January, 1913 (pp. 397 & 398).

Are these acts, and is the sequence of events significant of an intention to defraud anyone or of an intention to discontinue the business of the Company and make away with as much of the wreckage as possible? Assuming that the actors in the transaction possess but a small amount of the ingenuity credited to them by the Intervenors, is it possible that they did not appreciate that a far simpler way to obtain the First Mortgage Bonds would have been to immediately deposit those in hand as collateral to a demand note, and, shortly thereafter, call the note, sell the collateral and buy it in. Indeed, the very baldness and awkwardness of the transaction for the exchange of the bonds is only consistent with the idea that the parties considered that they were acting properly and rightfully. At all events, whatever their thoughts or beliefs may have been, the openness with which the transaction was accomplished, the complete record thereof that was made, and the deliberation shown in rendering it effective, are so wholly inconsistent

with an intent to defraud anyone, that only the mind of a Machiavelli can discover reasons to the contrary.

After this agreement had been considered at the Directors' meeting, according to the Minutes, a resolution was unanimously adopted authorizing its execution (p. 245). In addition to the directors representing Kissell, Kinnicutt & Company, the Syndicate or the Railway Company interests, assuming merely for the purpose of this argument that such directors represented the same interests, it will be recalled that the meeting was attended by Mr. A. E. Thompson, the attorney for Messrs. Mainland and by the two Mainlands, and there is not a syllable of evidence contradicting the record to the effect that *all of the directors voted in favor of the agreement whereby the Railway Company was to make the loan of $250,000, and, in part consideration therefor, was to have the privilege of exchanging the Second Mortgage Bonds for the First Mortgage Bonds.* As we have before pointed out, the agreement to release Messrs. Kissell, Kinnicutt & Company from their obligation to purchase the additional Second Mortgage Bonds is only of importance in the event that the Company was not insolvent and that the Second Mortgage Bonds were not considered worthless. If such were not the case, and the corporation were complaining, the agreement with the Bankers would be of some consequence, and it would be proper for the Court to consider whether or not the stipulation, whereby the Bankers agreed to procure the $250,000 loan, did supply a legal consideration for the release. Since it is not complaining, the question is wholly immaterial so far as these Intervenors are concerned. Were the subject one which the Court should consider, however, it is most confidently submitted that, in view of the existing deficit in the earnings of the Power Company and of its absolute requirements during the succeeding three months, not to mention the following three months, for which provision was intended to be made by the loan, whatever else may be said of the transaction, it cannot convincingly be claimed that it was not of the utmost importance to the Power Company that funds for its needs should be provided. Whether or not the consideration given was too great is, we submit, a question which does not concern these Intervenors, and one which, therefore, it is useless to prolong the brief for the purpose of discussing. If the Bankers were im-

properly released from their contract, the corporation and its stockholders are not without a remedy, but such remedy is personal to the corporation and the Bankers, and

B.

It also appears from Intervenors' Exhibit 3 (250-256) that, on Sept. 27, 1912, two days after the Directors Meeting, a meeting of the executive committee was held at which both of the Mainlands were present; that such meeting, by the votes of the two Mainlands and of Mr. Watson, authorized the making of an agreement which, among other things, recited (p.253) that the Bankers "have for a valuable consideration been released from their obligation to purchase said $175,000 face value of said bonds"; also that, "from various causes, the Bankers have been required" and have from time to time, advanced far more money than was originally contemplated"in the agreement of September 1911 and "have otherwise assisted beyond their contract obligation in carrying out the spirit" of said agreement. These minutes are signed by Mr. Sinclair Mainland as secretary (pages 253 & 256). These minutes are impugned in no manner whatsoever. Accordingly, whatever may have been the disposition of the Messrs Mainland on September 25, 1912, two days later, they evidently acquiesced fully in the arrangement to modify the original agreement in a variety of ways, among which were a number entirely dependent upon the release of the provision relating to the $175,000 bonds.

to deliver to Bates & Rogers Company 100 shares of full-paid common stock and 50 shares of full-paid preferred stock of the Railway

with an intent to defraud anyone, that only the mind of a Machiavelli can discover reasons to the contrary.

After this agreement had been considered at the Directors' meeting, according to the Minutes, a resolution was unani-

and one which, therefore, it is useless to prolong the brief for the purpose of discussing. If the Bankers were im-

properly released from their contract, the corporation and its stockholders are not without a remedy, but such remedy is personal to the corporation and the Bankers, and does not affect the question of the capacity and right of the Power Company to make the contract with the Railway Company. Evidently, all of the directors present, both those representing what may be termed the Railway Company interests and those representing what might be called the other interests, considered that the Power Company required the money obtained under the contract and that the terms under which it was to be obtained were proper.

Under the assumption that the parties intended and expected the business of the Power Company to continue, which, considering the evidence, is the only justifiable assumption, in addition to the benefit to be derived by the Power Company through obtaining funds to continue the construction work then under way and planned, one of the most important considerations, from its standpoint, was to keep its fixed charges down to the lowest possible sum; and, in this connection, the fact must be kept in mind that each Second Mortgage Bond exchanged for a First Mortgage Bond reduced the interest charges to the extent of one per cent., which, in the case of the entire $718,000 of bonds, meant a saving to the Company of $7,180 per year.

The second of the transactions of which complaint is made was authorized at a meeting of the Executive Committee, attended by all five of the members, on December 27, 1912, at which Mr. William Mainland acted as Chairman (pp. 400, 401). After the written contract of November 29th with Bates & Rogers Construction Company (pp. 401–404) was laid before the meeting, as evidence of the terms of the settlement of the controversies between the two companies, it was seen that it provided for the delivery to the Bates & Rogers Company of $25,000, face value, of the Power Company's Consolidated or Second Mortgage Bonds, together with an agreement on the part of the Railway Company to purchase the said bonds at any time after eighteen months at 80; also that the Power Company was to deliver to Bates & Rogers Company 100 shares of full-paid common stock and 50 shares of full-paid preferred stock of the Railway

Company. Thereupon, an agreement between the Bates & Rogers Company and the Power Company was presented to the meeting, which had theretofore been executed by both companies under date of December 16, 1912 (pp. 405, 406), and which provided for the cancellation of the contract between them, included mutual releases and released and discharged the Mainland firm from all liability under their guarantee to the Bates & Rogers Construction Company of the performance of the Power Company's contract. Following this there was also presented to the meeting a contract between the Power Company and the Mainlands, whereby the Power Company delivered to the Mainlands $60,000, face amount, of its First Mortgage Five Per Cent. Bonds, as security against any liability incurred by them as endorsers upon a note given the Bates & Rogers Company which was to mature November 29, 1913, which agreement had also been executed on December 16, 1912 (pp. 407, 408). Thereupon, it was unanimously resolved that the action of Mr. Mainland in effecting the settlement with Bates & Rogers, his execution of the Company's note and also that his execution in its behalf of the agreements in question were duly ratified and approved.

Thereafter, an agreement between the Power Company and the Railway Company was presented to the meeting, which recited the adjustment of the controversy between the Power Company and the Bates & Rogers Company and the requirements thereof so far as the Railway Company was concerned, provided that the Railway Company should deliver to the Power Company 50 shares of its full paid preferred and 100 shares of its full paid common stock and that it should execute and deliver to the Bates & Rogers Company an agreement in the form of that thereunto annexed and marked Exhibit "A," which is the agreement providing for the purchase by the Railway Company from the Bates & Rogers Company of the $25,000, face value, of the Power Company's Consolidated or Second Mortgage Bonds at 80.

The record contains testimony on the part of the Messrs. Mainland to the effect that they did not recall having passed upon the said agreement of December 27th between the Power Company and the Railway Company (pp. 418–421). The rec-

ord also discloses, however, that Mr. William Mainland executed the settlement agreement of November 29th with the Bates & Rogers Company (p. 404) ; that he executed on behalf of the Power Company, as its President, the agreement between the Bates & Rogers Company and the Power Company of December 16 (pp. 405, 406) ; that he executed on behalf of the Power Company, as President, and on behalf of his firm, the agreement between them of December 16, 1912 ; and that he also executed, as President of the Power Company and as President of the Railway Company, the agreement between them of December 17, which includes the right on the part of the Railway Company to exchange additional Second Mortgage Bonds for First Mortgage Bonds up to the sum of $500,000. In other words, this particular agreement, which the learned Court below especially anathematizes as unconscionable on the part of the Railway Company, was executed in behalf of the Power Company as well as in behalf of the Railway Company, by Mr. Mainland, who was not one of the Bankers, who was not a member of the Syndicate, who, with his brother, entirely controlled the Power Company before the Bankers made the contract of September, 1911, and who must, therefore, be considered as representing all of the stock other than that originally acquired by the Bankers and by them transferred to the Railway Company.

In connection with this transaction, it will be recalled that the uncontradicted evidence is that a disagreeable and difficult situation existed between the Power Company and the Bates & Rogers Company resulting from a contract made some years before for the development at the Ox Bow ; that the matter of its cancellation or of making some arrangement to be rid of the liabilities thereunder had been under negotiation for many months. The general considerations affecting the desire to terminate the contract are set forth in the testimony of Mr. Watson at pages 266–268. As a matter of fact, the negotiations had been under way since the fall of 1911, when Mr. Watson first became the Power Company's Manager (p. 268). On July 24, 1912, a proposal of the Bates & Rogers Company was presented to the Power Company's Executive Committee by Mr. William Mainland (pp. 268–270) under which, as the

result of the negotiations theretofore had, the Bates & Rogers Company offered to adjust their claims at something more than $85,000. This offer was rejected and a counter proposal authorized (pp. 270 & 271). Mr. Watson also showed that in June, 1912, Mr. Blackwall, of Messrs. Veile, Blackwall & Buck, the Power Company's engineers, wrote him that he had been conferring with Mr. Rogers, of the Bates & Rogers Company; that the latter were very anxious to go on with the work on the basis of the unit prices in the contract, and that, if the work should be done on that basis, it would cost $100,000 more than if the Company did it directly; and Mr. Blackwall's letter is in evidence (p. 280).

Before passing to a further consideration of this contract, we pause to refer to the only testimony in the case with respect to the actual exchanges of bonds made under the two contracts. The testimony was given by Mr. G. E. Hendee, who was the Secretary and Treasurer of both Companies. As before shown, he testified that the $250,000 was loaned at the following times and in the following amounts:

October 4, 1912	$100,000
November 1, 1912	20,000
December 11, 1912	60,000
December 17, 1912	40,000
January 3, 1913	30,000

He also testified that $440,000 of the First Mortgage Five Percent Bonds were first put up as collateral against these loans and that afterwards they were exchanged for a like amount of Consolidated Six Percent Bonds, and the Railway Company thereupon accepted the Consolidated Bonds as collateral for the loans (p. 258). He also testified that the Railway Company delivered to Bates & Rogers Company the 100 shares of common and 50 shares of preferred stock and $25,000 of the Consolidated Bonds, that the "requisition" (evidently the witness intended to say "contract" or "agreement") stated that the Railway Company would purchase the bonds at 80 under the terms of the settlement agreement with the Bates & Rogers Company (p. 259).

The witness then testified that, under the two agreements of September 26 and December 27, 1912, referred to in the

Minutes of those dates, the following exchanges of bonds were made :

January 3, 1913	$ 38,000
January 6, 1913	492,000
January 13, 1913	65,000
February 10, 1913	123,000

Thereupon, he gave the serial numbers of the bonds received by the Railway Company, all of which are included among those requisitioned, issued and delivered to the Railway Company as shown by the stipulation appearing at pages 396-398 of the record. The witness also stated that none of the loans had ever been paid to the Railway Company.

In addition to the matters hereinbefore mentioned, in speaking of the September transaction, the learned Trial Court, in referring to the agreement on the part of the Bankers to procure the $250,000 loan from the Railway Company, characterizes the Railway Company as being then " wholly insolvent " and, in referring to the loan of $250,000, states that " under the conditions created by the agreement the possibility that there ever would be a redemption (of the First Mortgage Bonds originally pledged as collateral) was so remote as to be negligible"; states that the surrender of the obligation " of the Syndicate to take $175,000, face value, of the Seconds at 80 " was, " without any real consideration " and, as we have before shown, concludes that there is but one rational explanation of the agreement, namely, that the interests in control of the Railway Company, having concluded that the Power Company was hopelessly insolvent, resorted to this expedient for saving to themselves as much of the wreckage as possible. The only evidence in the record with respect to the condition of the Railway, at that time, is contained in Intervenors' Exhibit 28 (pp. 213, 214) and Intervenors' Exhibit 29 (pp. 216-218). From the former, it appears that, during the month of September, 1912, the Company earned a surplus of approximately $3,400 ; that for the nine months ending September, it had earned a surplus of a little more than $6,800 ; that for the month of September it expended in construction work $69,637, and during the nine months then ending $267,463.

From Exhibit 29 we find that up to September 30, 1912,

additions had been made to Property, Plant and Equipment, aggregating $627,463, and that during the month of September such additions had been made to the extent of $79,637.

Concerning the condition of the Company thereafter, from Intervenors' Exhibit 5 (pp. 205, 206), we find that for the year ending December 31, 1912, the earnings show a surplus of $14,527 :

That on December 31st, the Construction Account for the year was	$440,235
Whereas, on September 31st, it had been	267,463
Showing an increase during the 3 months, of	$172,772

From the condensed balance sheet of December 31st (Intervenors' Exhibit 27, pp. 208–210) we find that total additions to Plant during the year 1912 were ~~$020,235~~. 620,235

Whereas, up to the end of September such additions aggregated	357,463
Thus showing an increase during the 3 months of	$262,772

The Balance Sheet of December 31, 1912, also shows total assets of $23,803,000, and total liabilities, excluding the Capital Stock, of somewhat more than $16,000,000, thus showing a surplus of about $7,000,000.

The only other evidence in the record bearing upon the question is that about December 23, 1913, more than a year after the Bates & Rogers transaction, and more than 15 months after the loan of $250,000, a Receiver for the Company was appointed, upon its confession of insolvency (p. 381).

Not only do we have the figures above mentioned, but there is no contradiction in the record, and no suggestion of a contradiction, of the fact that the Railway Company did actually loan the Power Company the $250,000 as provided in the September contract.

Under this state of facts, and in view of the law regarding the proper meaning of the word "Insolvency" as applied to corporations, we trust that the Court will not consider the statement unjustified if we characterize the language of the learned Trial Court in this regard as intemperate; and if we again suggest that it is only intelligible upon the assumption that, at the end of August, 1914, when the opinion was written, the Court was subconsciously affected by the circumstance,

that, through its Receiver, it had then been administering the affairs of the Railway Company, as well as those of the Power Company, for a period of eight months, and, that it was transferring to September, 1912, the conclusions which it had then reached as to the possibility of realization upon the Railway Company's properties in August, 1914, by which time, we presume that properties of that particular character were of less selling value in the home community of the learned Court than has ever been the case since the inhabitants of the community dwelt in wigwams and, for the sake of the development of the community in the future, let us hope of less value than will ever again be the case.

The learned Court further said that, under the conditions *created* by the agreement, the possibility of redemption of the pledged bonds was so remote as to be negligible. If by that statement is meant that, in view of the limited quantity of first mortgage bonds to which the Company was entitled by reason of the improvements and additions to its property, if the exchange privilege was availed of, small opportunity would be afforded to redeem the bonds as pledged, the remark is understandable ; otherwise it is not, because, with the security markets in the condition which obtained at that time, with the Company showing a large deficit in its earnings, and especially in view of the fact that most of the five per cent. bonds had been put out at 70 under most favorable statements of earnings (although such statements were unwarranted), it would have been the height of folly to have then forced the first mortgage bonds on the market ; and by the terms of the agreement the securities ultimately held in pledge could not be sold until one year after the respective loans were made, at which time it was possible that the condition of the Company would be improved and, at least from the standpoint of human hopes, it was probable that financial conditions would have improved.

The Court continues :

> "The transaction, therefore, practically amounted to a sale of between $200,000 and $500,000 face value of the first mortgage bonds for an equivalent amount of seconds, which it is apparent must have been wholly valueless if the first were worth less than their face."

From the tables to which we have previously referred (pp. 437–453), it is shown that the Company had never realized par on any of its six per cent. first mortgage bonds, except $10,000 thereof, and that all but $72,000 thereof had been sold at 80 and 85, the greater proportion at the smaller price. Under its most favorable statements of earnings, therefore, the Company practically never realized par for even its six per cent. first mortgage bonds ; notwithstanding which, the longer of the tables last mentioned shows that, in January, 1911, it sold $50,000 of the seconds at 85, and $200,000 at 80 ; that in February of the same year it sold $75,000 of its seconds at 80 ; that in March of the same year it sold $49,000 thereof at 80 ; that in April of the same year $25,000 thereof were sold at the same price ; in May $7,000 at the same price ; and in June $7,000 at the same price. In addition to which, after the dates mentioned, the Bankers purchased $1,325,000 thereof at the same price. Accordingly, judged by these transactions, the observation of the Court to the effect that the seconds were wholly valueless if the firsts were worth less than their face, would seem to be a glaring *non sequitur.*

As the Railway Company was entitled to exchange $500,000 first mortgage five per cents. under the September contract, and $718,000 were exchanged under both contracts, it is only proper to assume that $500,000 of that amount was exchanged under the first contract. Considered, therefore, in the worst possible light, since the Power Company received the entire $250,000 from the Railway Company, the transaction under the first contract might be said to represent a sale by the Power Company of its five per cent. first mortgage bonds at 50 plus whatever value the parties then fairly considered the second mortgage bonds to possess. If the value of the second mortgage bonds was then placed as low as 25, the realization by the Railway Company on the first mortgage 5s was, notwithstanding the then conceded fact that its earnings showed a large deficit, as satisfactory as previous sales of the same bonds under conditions when its earnings purported to show a large surplus. And if, as we most confidently contend, the circumstances then surrounding the transaction of the business of both the Power Company and the Railway Company, emphasized by the subsequent expenditure for construction

and other additions to the plant and equipment of both companies, aggregating during the succeeding three months more than $400,000, disclose clearly that the parties in interest then considered that both companies could and would be maintained as going concerns, is this Court, or any other court, justified in concluding that the second mortgage bonds were not then honestly considered by the parties to be worth more than 25 cents on the dollar?

So far therefore as the transactions under the first contract are concerned, had the parties really under attack here been notified by the pleadings herein that the intervenors attacked the transactions in question upon the ground that the Power Company was at the time insolvent and known by them so to be, in view of the evidence in this record, it would seem to be beyond peradventure that, under the proper definition of insolvency, they could have readily met and repelled such an attack. The point upon which we insist in that connection is, however, that the conclusions of the Court in that regard are assumptions pure and simple and that, if assumptions are to be indulged, they should be based upon the evidence; that the record does contain evidence in actual figures disclosing what both companies were then doing, the only reasonable and justifiable conclusion from which is that the parties who were then financing them intended to continue so to do, in which event neither of the companies was insolvent and the future alone could tell whether the great investments in both properties then being made and others which it was anticipated would follow, would or would not ultimately result in the financial success of both ventures.

We do not now consider further the Court's remark that the obligation to take the additional $175,000 face value of second mortgage bonds was that of the Syndicate, because we will subsequently discuss that finding in some detail.

After concluding that the transaction was an "expedient for saving * * * as much of the wreckage as possible," learned trial Court observes that:

> "Putting aside for the moment all question of the rights of these intervenors, it is plain that there was a breach of trust on the part of the officers of the Power Company and a disregard of the rights of the holders

> of approximately $166,000 face value of consolidated bonds which had been sold upon the market and were held by the general public," etc.

This statement is so wholly gratuitous on the Conrt's part that we would not advert thereto did we not consider that its inclusion in the opinion, concededly without relevance to the real issues, is significant of a severely prejudiced state of mind, which, in addressing himself to the real issues before him, he found it impossible to overcome. We do not make this remark by way of individual criticism but only as indicating the extent to which able courts are sometimes affected by considerations other than those of abstract reason and as further suggesting that the trial Court was influenced by sentiment in reaching its conclusions.

By way of antidote to such sentiment, we may be permitted to point out that the table of sales of the Company's bonds (pp. 439–453) show total sales of the consolidated 6s, or second mortgage bonds, of $413,000 up to June 13, 1911. The New York bankers became interested in the Power Company in September, 1911. The evidence shows (p. 260) that at the present time the Railway Company holds all of the outstanding second mortgage bonds except the $166,000 mentioned by the trial Court and $30,000 held by the Bates & Rogers Construction Company. In other words, not only were the New York bankers or the Syndicate or the Railway Company not parties to the sale of the $166,000 of seconds, the position of the holders of which appealed to the learned trial Court, but, after becoming interested in the property, they had purchased the difference between the $413,000 thereof theretofore sold and the $166,000 thereof now outstanding, or $247,000 of such bonds. In considering the intentions of the Bankers, of the Syndicate and of the Railway Company, it must also be kept in mind that every bond held by the intervenors or any others, was ~~purchased~~ issued before the Bankers, the Syndicate or the Railway Company had any interest in the Power Company; that, after the Bankers first acquired their interest, they did nothing but expend, in the improvement and development of the property, the money with which they had purchased the Company's bonds, every one of which is now in their hands. Accordingly, to the extent that the human influences

involved are to be considered in connection with the duty to the public of those responsible for the administration of the affairs of these companies, and particularly for the sale of its securities to innocent holders, without desiring to enlarge too much upon the situation, we may at least say that the situation of the Bankers, of the Syndicate and of the Railway Company is above reproach. Indeed, had not the Bankers expended upon the property of the Power Company the great sums shown even by this record, in view of subsequent events, these very Intervenors and all other holders of the Power Company's first mortgage bonds would indeed have been in a pitiable plight. We close the discussion of this particular thought with the recurrent reminder that the holders of the $166,000 of second mortgage bonds are not the complainants here, and that, to whatever other encomiums these Intervenors and their counsel may be entitled, any well defined desire to protect the interests of the second mortgage bondholders cannot be said to be one of them.

We offer but one further thought in this connection, namely, that the learned trial judge is rather illogical in basing his condemnation of the exchange of bonds upon the circumstance that the seconds were wholly worthless, and in charging the Railway Company with a breach of trust toward the other holders of the second mortgage bonds growing out of the same transaction. In other words, if the consolidated bonds were entirely valueless, what difference did it make to the other holders thereof what disposition the Railway Company made of its second mortgage bonds?

As we have heretofore pointed out, both upon reason and authority, the officers and directors of a corporation bear no trust relationship whatsoever to its creditors, be the latter secured or unsecured. We most respectfully repeat, therefore, that it was ill advised for the trial Court to characterize the transaction as a breach of trust on the part of the officers of the Power Company, especially as the statement was not required for the purposes of the decision. As should be the case, judicial utterances have great potency. It is well known that all opinions of the federal courts are preserved in written form and published broadcast to the world. In the opinion of the learned Court below, names are mentioned in connection with statements and conclusions involving findings of fraud in

business transactions; names of honorable men, who are naturally jealous of the places which they have made for themselves in the world. To the extent that such mention is necessary, advisable or proper in connection with the essential conclusions of the Court, we may not quarrel with such exploitation as the circumstances require or justify. We trust, however, that we may be pardoned the display of some feeling in discussing the propriety of the use of names, at the risk of possibly affecting honorable reputations, in connection with the characterization as breaches of duty and trust of circumstances which are not presented to the court for judicial action.

The learned Court further observes that:

> "Assuming that they (the Railway Company interests) were entitled to sympathy, it does not follow that they were entitled to protection. Their misfortune in nowise enlarged their rights as parties to the contract *or abated their duty as trustees of the Power Company.* As directors they were bound to subserve the interests of the Company, and *to hold its property for the common benefit of its creditors,* and they were not privileged to strip it of its meager remaining resources for the purpose of recouping their private losses. The adoption of any other view would necessarily be to recognize the rule of might, and to say for him to take who can."

Animadverting upon these observations for a moment, it is pertinent to inquire why those who had advanced great sums to the Company and were arranging to advance other great sums, were not entitled to protection, if it could be obtained without prejudice to the rights of others, which is the only reasonable, logical and, therefore, just view which can be taken of the results of these transactions. As we will show hereafter, it was money taken from the earnings of the Company and the money received from the sales of the second mortgage bonds which had been put into the property and thereby enhanced the value of the lien securing the bonds of these Intervenors. To the extent that the money represented earnings, it was taken from other creditors and the stockholders; to the extent that it represented the proceeds of the

sale of the second mortgage bonds, it was a direct contribution by the holders of those bonds and by other creditors and stockholders, because such moneys might properly have been used to reimburse the Company and, therefore, other creditors and stockholders, for the amount of the earnings reinvested in the property. Accordingly, were we dealing with abstract equities, and were it necessary to enlarge upon that view for the purpose of maintaining the position which we assert, we might argue at length that it is highly inequitable that the Intervenors should be content to accept the vast increase in security resulting from such expenditures and close their ears to any consideration of the losses suffered by those who supplied the funds which made such increase possible. As we shall show hereafter, the Intervenors have everything for which they contracted ; for which reason, if the transactions in question may properly be said to be measures of protection on the part of those who had been and were continuing to invest large sums in what the Court considered to be an absolutely insolvent enterprise, upon what ethical or moral consideration is the finger of judicial scorn to be pointed at them and are they to be branded as fraudulent conspirators ?

We do not know to what the learned Court refers in stating that

> " Their misfortune in nowise enlarged their rights as parties to the contract."

So far as we are aware, no one has claimed that the actions of the directors representing the Railway Company interests enlarged their rights as parties to any contract ; indeed, our position is that the acts of which complaint is made were specifically authorized by a written contract made openly and with respect to which a most exact and complete record was retained. It is the intervenors who are seeking to " enlarge their rights as parties to the contract." Their rights are exactly measured by an elaborate written instrument, the terms of which they concede the other parties thereto have rigidly performed, notwithstanding which they are here making grave charges against others who are claiming only the rights secured to them by their contract.

We do not suggest that the misfortunes of the Railway

Company interests "abated their duty as trustees of the Power Company." We assert only that, as trustees of the Power Company, they were not trustees for these Intervenors and that, accordingly, if that which was done deprived these Intervenors of nothing to which they were entitled by the terms of their contract, as between them and the officers of the Power Company, no occasion exists for considering any question of breach of trust or other duty. In discussing abstract questions of breach of trust and duty by the Railway Company interests, the fact must be kept in mind that the Railway Company owned practically all of the capital stock of the Power Company. As they also owned all of the second mortgage bonds, with the exception of $166,000 thereof, they also owned practically all of the second mortgage lien on the property. This record does not disclose to what extent they also held the general unsecured obligations of the Company. Be that as it may, however, with the exception of the small outstanding stock interest, which does not complain, they themselves occupied the position of those for whom, in any sense, they may properly be said to have been trustees. Under such circumstances, if they stipulated that, if they are to advance an additional $250,000 or any other sum to a company situated as was the Power Company at that time, they would only do so upon the condition that their security be increased and that, thereby, their position as creditors be improved, without detriment to the rights of other creditors, who is to gainsay their wish and who is to properly charge them with a breach of trust or with seeking to establish "the rule of might"?

Because it would too much prolong the discussion, we do not follow the somewhat overdrawn and almost fantastic observations of the Court with respect to the situation of the Bankers or of the Syndicate or of the Railway Company under the contract of September, 1911, because he repeats in that connection his tendency to discuss questions which, in this particular instance, he concedes to be immaterial, into which discussion we will not again be drawn.

In passing, however, it may not be amiss to remark that, if the Bankers or the Syndicate or the Railway Company are disappointed in their failure to reap the profits which they anticipated, is their position different in that regard from the

anticipations of the Intervenors or other predecessors in title to the bonds which they represent. With inconsiderable exceptions, those bonds were purchased at less than par. As shown by the tables of one of the brokers (pp. 324–333), he purchased many of his bonds with a bonus of thirty per cent. in stock and, with practically all which he sold, he delivered a bonus in stock running from ten to twenty-five per cent. As shown by the tables of another broker (pp. 333–340), a bonus of twenty-five per cent. in stock accompanied many of the bonds which he obtained, which bonus, from his statement of sales, he apparently retained. In varying degree, therefore, may we not paraphrase the statement of the Court with respect to the Railway Company interests and, applying it to such purchasers, also say that:

> "They bargained for the chance of profit in a speculative enterprise and they must have contemplated the risk of loss as well as the chance of gain."

Whatever else may be said with respect to that statement, as applied to the Railway Company interests, are one's duties or obligations to third persons to be enlarged or his rights to protection diminished by the circumstance that his money is invested with the expectation of deriving therefrom a profit ?

Turning now particularly to the transaction of December, 1912, and to the consideration thereof by the learned trial Judge, he states that:

> "In consideration of the Railway Company's agreement to deliver to Bates & Rogers 100 shares of its own stock, *which was worthless*, and 50 shares of its preferred stock, *which was equally worthless*, and its obligation to pay the bonds, which, *because of its insolvency*, if for no other reason, was unenforceable, and hence practically of no value, the Power Company was made to agree that it would, upon demand of the Railway Company, deliver its first mortgage bonds up to $500,000 face value * * * in exchange for consolidated bonds, which also were *without substantial value*." (Italics ours.)

We will not here repeat our views upon the assumptions of insolvency and of the consequent worthlessness of the stock of the Railway Company and of the second mortgage bonds of the Power Company, except to again call attention to the fact that the only evidence in the record concerning the financial condition of the Railway Company, discloses a large equity for the stock, and to again express our surprise that, in view of such condition of the record, the Court should have reached such a conclusion. Evidently the Bates & Rogers Company attached value to the stock, and it is to be assumed that their reasons for so doing are justifiable; also that they attached value of the Railway Company's agreement to repurchase the consolidated bonds as, otherwise, they would not have required it. We also wish to recall the fact that Bates & Rogers claimed damages under their contract, up to the then present, amounting to more than $85,000, and that the Power Company's engineer had advised it that to continue construction under that contract would increase the cost of the work to the extent of $100,000. Accordingly, if the parties to the transaction considered that the stock of the Railway Company possessed substantial value and that the obligation of the Railway Company to purchase the consolidated bonds was worth $20,000; if, by settling the Bates & Rogers claims, the Power Company was relieved of an obligation of $85,000 and saved an additional expenditure of $100,000 in connection with the contemplated work at the Ox Bow; and, assuming that the parties also considered, and justifiably so, that the second mortgage bonds of the Power Company did at that time possess substantial value, whatever else may be said of the transaction, can it be properly or fairly contended that the Power Company received no consideration therefor? And, though the consideration were meager, what badge of fraud attached to the transaction and who was defrauded?

The learned Court follows the statement last quoted with this:

> "From the testimony and the surrounding circumstances, *no doubt is left in my mind that the Power Company could have made settlement directly with Bates*

& Rogers with its first mortgage bonds at a comparatively small discount, and that the devious course was adopted not upon their demand or for the interests of the Power Company or of any of said creditors, but for the sole purpose of furnishing a pretext for getting the first mortgage bonds out of the treasury of the Power Company and into the hands of the Railway Company and for the interests alone of those by whom the latter company was dominated."

As we consider the italicized portion of the statement one of the most surprising contained in the opinion of the learned Court, we have carefully searched the evidence for the purpose of determining what may be the basis thereof. The only reference thereto which we find is contained in the deposition of Mr. William Mainland (pp. 312-314). After detailing the circumstances of the meeting with Mr. Rogers, at which the matter was discussed, he continued :

> " I said, ' Mr. Rogers, this matter is, as you know, in your brother's hands; as I know it is in Mr. Wickes' hands, I don't want to butt in.' ' Well,' he says, ' whatever you say I will not consider it such and what I say is not official,' and we had a discussion then about the settlement.
>
> " Q. During Mr. Wickes' negotiation, as I recall, he had suggested some bonds, more than twenty-five? A. More than twenty-five and no stock and I said, ' *What is the use of putting up so many bonds if you are going to redeem them anyway? No use tieing that many additional bonds up.*' And Rogers and I discussed consolidated bonds and the first and refunding bonds and the stock proposition, the shares of stock, and he said, ' What about the first mortgage bonds? ' He would consider taking those *as he still believed in the project*, etc. And I said, ' *I don't think you can get any of those, I don't believe so ; but it is possible that you might get the Railwag to guarantee*,' which I had in fact discussed with Mr. Wickes before that, though I didn't *tell* Rogers then ; and before going away he said, ' If you can put

that trade through as it appears, I believe I will accept it;' and of course he asked me what my judgment was on the Railway guaranty, *and I said to him I believed that it was all right*," etc.

To what the learned Court referred as the "surrounding circumstances," we do not, of course, know. So far as direct evidence is concerned, however, can there be two opinions as to the reasonable and proper understanding of Mr. Mainland's statement and of its effect upon Mr. Rogers? In so many words, he testified that he told Mr. Rogers that he did not think that he could get the first mortgage bonds, and then suggested that he take the Railway Company's guaranty. There is no suggestion in the record anywhere that Mr. Mainland was one of the arch conspirators. Indeed, his testimony is much exploited by the Intervenors in support of their case. With this statement uncontradicted and unimpeached in any way, in all fairness, what can be the basis of the Court's statement that the course adopted was solely for the purpose of furnishing a pretext for getting the first mortgage bonds. As Mr. Mainland stated, he believed that the guaranty of the Railway Company was absolutely good, and evidently Mr. Rogers shared this belief. Evidently, also, what Mr. Rogers wished was the best security available for $20,000. In view of the growing deficit in the Power Company's earnings, is it probable that he would have preferred the Railway Company's first mortgage bonds at 80 rather than the absolute guaranty of what everyone then considered to be and what was an entirely solvent and responsible corporation?

And what is the justification for the Court's conclusion that Bates & Rogers would have accepted the first mortgage five per cent. bonds "at a comparatively small discount"? Surely Mr. Rogers was in a position to know as much about the then condition of the Power Company as was the learned trial Court from the evidence in this record, which evidence discloses, among other things, that the five per cent. bonds had, when the Company's earnings were stated in a most attractive fashion, sold at 70, at which price $30,000 of the $51,000 then outstanding had been sold, and at 75, at which price others of such bonds had been sold (p. 453). No reason whatsoever suggests itself why Mr. Rogers would have been

content to take those bonds at a price to net the Company 70. What he wished was $20,000 ; and he considered, and, undoubtedly, everyone else concerned in the transaction considered, that the guaranty of the Railway Company assured him that sum much more certainly than the first mortgage five per cent. bonds at any price at which it may fairly be considered that he would have taken them. Again we are compelled to say that it appears to us that the mind of the learned trial Court has been affected by some circumstance or circumstances other than those in this record and that, for the purpose of reaching his conclusions, he has indulged assumptions utterly unjustified by any of the evidence.

We repeat then, what is the evidence of fraud which impugns these transactions ? This inquiry cannot be answered by asserting that the Railway Company interests committed a breach of trust toward other second mortgage bondholders or that they failed in their duty to the Power Company or to its stockholders. As we have seen, in behalf of creditors, the transaction can be condemned only in the event that it was done with *intent* to hinder, delay or defraud these particular creditors. It may have been unwise, it may have been unjustified as between the Company and its stockholders or as between the Railway and other second mortgage bondholders, but was its intent fraudulent ; that is, was the motive bad pure and simple ? As we have seen from quotations previously made from *Bigelow on Fraud*, that learned author points out that, if the transactions be accompanied by present consideration, it is difficult to conclude that a fraudulent intent existed. It is a truism that fraud will not be presumed, but must be shown and proved ; and that, although transactions may be suspicious or be such that a particular individual may condemn them, unless circumstances are shown from which the deliberate desire and intent to defraud appear, they are not within the Statute of Elizabeth.

Under the discussion of the weight and sufficiency of evidence in actions to set aside transactions on the ground of fraud, it is said :

> " Fraud, however, must be proved *as an affirmative fact*, and the proof must be of such a positive and definite character as to convince the mind of the

court, *for it is never presumed*, and if the acts shown all comport as well with honesty as with fraud, the transaction should be upheld" (20 *Cyc.*, 785).

Again:

"The mere fact that the transaction in question is prejudicial to creditors does not defeat it. The evidence must be of such character and degree as will justify reasonable men in arriving at a conclusion that fraud existed; and evidence that merely casts a suspicion on the transaction is not sufficient to vitiate it" (20 *Cyc.*, 791).

"The creditors of a party defrauded have no right, even though the fraud has the effect of diminishing his means of paying them, to look into such fraud or unravel it. It is for him and him alone to do so, and *if he chooses to acquiesce in the fraud, or suffers himself to be concluded of his right to investigate or undo it, his creditors must be content to abide by the legal rights remaining in him.* There is a manifest distinction between a fraud upon the debtor and a fraud upon creditors. In the one case the debtor is the victim and guilty of no wrong, while in the other he is himself either in fact or in law the perpetrator of a fraud. In the latter case the creditors who seek to avoid a sale or transfer do not represent the debtor, but exercise rights paramount to his. In the former case *the remedy belongs to the debtor alone, and they cannot interfere when they are not in contemplation of the author of the wrong*, and are only affected consequentially."

Bump on Fraudulent Conveyances, 4th Ed., Sec. 20.

"*A fraud upon creditors consists in the intention to prevent them from recovering their just debts, by an act which withdraws the property of the debtor from their reach.*"

Id., Sec. 21.

In *Foster v. M'Alester*, 114 Fed. 145, the plaintiffs, having a chattel mortgage on two stocks of merchandise in Arkansas,

permitted the mortgagor to remove the goods to Indian Territory and transfer them to Terrell & Co., a firm of which he became a member, under an agreement that such firm would assume plaintiffs' debt and give them a mortgage on this stock at any time requested. The Arkansas mortgage was not recorded in Indian Territory. The defendants wrote plaintiffs inquiring about the financial condition of Terrell & Co. and its credit, to which plaintiffs replied that they considered its credit good, making no mention of the Arkansas mortgage or of the agreement for the Indian Territory mortgage. The evidence showed that, in fact, Terrell & Company's credit was not good. After making such inquiry, defendant sold goods to Terrell & Company. Thereafter, plaintiffs requested and obtained the mortgage which Terrell & Company had agreed to give them ; took possession thereunder, and, in conjunction with the mortgagors, were selling the merchandise in the usual course of business, applying the daily proceeds to the mortgage debt. The defendants attached the merchandise on the claims resulting from the goods sold Terrell & Company by them after making the inquiry of plaintiffs, and the goods were sold pursuant to the levy under the attachment. Plaintiffs brought the action to recover the value of the goods sold under the attachment. Defendant set up that the transactions between Terrell & Company and plaintiffs were, as to the defendants, fraudulent. The trial judge charged the jury that the following were badges of fraud on the part of the plaintiff :

1. The failure to record the Arkansas mortgage ;

2. The failure of the plaintiffs to mention the Arkansas mortgage and the agreement for the Indian Territory mortgage when the defendants inquired as to the financial condition of Terrell & Company ;

Held error ; that the burden of proving fraud was upon the defendants, which burden they had not sustained. Among other things, the Circuit Court of Appeals for the Eighth Circuit said :

> " An act which in itself is lawful and innocent is never presumed to be fraudulent, and the burden rests on the party assailing it as fraudulent to prove it. * * * The law will not deduce fraud from any num-

> ber of lawful and innocent acts. One who seeks to attach a fraudulent character to such acts must go further, and show *they were in fact done with a fraudulent intent and for a fraudulent purpose.* * * * Fraud cannot be inferred either by the Court or jury from acts legal in themselves, and consistent with an honest purpose."

In *National State Bank v. Wheeler*, 40 N. Y. App. Div., 563, it was held that a conclusion of law that the *effect* of a voluntary conveyance was to hinder, delay and defraud creditors could not be sustained in the absence of a *finding of fact* that it was made with *intent* to hinder, delay and defraud creditors. The action was brought by a judgment-creditor with execution returned unsatisfied, but the Court said :

> "There must have been an intent in making the conveyance to hinder, delay and defraud the creditors. *The question of intent is one of fact, and must be both alleged, proved and found to warrant the judgment.*"

In view of the language last quoted, it is pertinent to again point out to the Court that the Intervenors' bill makes no charge that the transactions with respect to the 718 bonds were had with intent to hinder, delay or defraud them or any other creditors ; that, accordingly, the respondents were not called upon to meet any such issue and did not seek to meet it upon the trial. If, therefore, this decree is to be sustained upon the ground that they were had with intent to hinder, delay and defraud creditors, an issue will have been determined which was not presented by the pleadings and notice of intention to present which was not given the respondents.

In *Chick v. Fuller*, 114 Fed., 22 (Circuit Court of Appeals, 7th Circuit) (Petition for writ of *certiorari* denied, 187 U. S., 640), a mortgage was given by a corporation to secure bonds to pay its indebtedness to two banks, in which directors and stockholders of the corporation were also stockholders. The corporation was in fact insolvent at the time, but that circumstance resulted from the dishonesty of its president and was not

known to the directors and stockholders who were interested in both companies. Held that the mortgage was valid as against judgment-creditors, because it was given by a going concern in the expectation that its business would be continued.

The last-mentioned case is cited not as directly in point under the facts here, but as disclosing that the effect of a given transaction will not be held to constitute fraud upon creditors and that it is not the *fact* of insolvency which entitles creditors to a standing to complain of a given transaction, but the understanding of those participating therein as to whether or not the company's business is to be continued.

> " A fraud such as will authorize a creditor to set aside a conveyance made by his debtor must be one directed by the debtor against his creditors, *and not one practiced by third parties against the debtor. If a debtor has been overreached in a transaction, he may avoid it himself, but a creditor of his has no standing to do so.*"
> 14 *Am. & Eng. Enc. of Law*, 2d Ed., 266.

The statement last quoted expresses the fundamental proposition which we contend to be involved in determining if the Intervenors, as creditors, have, as stated by the learned trial court, any standing to attack the transactions upon the ground of fraud. That is to say, in order to give them any standing for that purpose, it is not sufficient for them to show that the directors of the Power Company intended to improve their position at the expense of the Power Company or of its stockholders, but that, in arranging the transactions, their well-defined purpose was to defraud these Intervenors; and in determining that point, as we have seen, it is not sufficient that the transactions did, as a matter of fact, affect the position or security of these creditors. That the record contains not a scintilla of evidence justifying any such conclusion, we most earnestly and sincerely believe and assert.

In *Damarin v. Huron Iron Co.*, 47 Ohio St., 581, the action was brought by a creditor to set aside mortgages given by the defendant to certain banks, including one in which two of the directors were also directors of the mort-

gagor. The mortgages were given to secure a pre-existing indebtedness, and the Court found, as a fact, that, at the time " though the corporation was insolvent *to the knowledge of its officers*, its general commercial credit remained good, and that it was in the control of its property, actively prosecuting its business, and expected to continue to do so as before." In holding that none of the mortgages could be set aside, the Court said:

> " The right of a company, though embarrassed, to continue its business and to retrieve its fortunes, if possible, must be conceded to it as well as to natural persons, and *this right necessarily carries with it the power to obtain an extension of credit by giving a mortgage upon its property to such of its creditors as are unwilling to give further time, unless so secured.* When this power is fairly and honestly exercised, with no purpose at the time of immediately abandoning business or making an assignment, the validity of a security so obtained cannot well be questioned."

Are not the observations of the Court in the case last mentioned especially pertinent here? The only evidence in the record that any of the directors of the Company considered at the time the possibility that the Power Company's business might not be continued is the remark on the part of Mr. Watson to the effect that, in a general way, he had some doubt as to its ability to go on and that of Mr. Wiggin to the effect that he understood that, unless the Company obtained the $250,000, it would fail. Instead of, as in the last mentioned case, being limited to the acquisition of security for an existing indebtedness, as the result of obtaining which the creditor withheld proceedings against the Company, the transactions in the case at bar enabled the corporation to obtain funds with which to continue its business unhampered. Since the question of fraud is unimportant if the Company were not insolvent in the sense that its business was to be abandoned and since the record does not contain a scintilla of evidence to the effect that any one at that time intended otherwise than that the moneys then supplied would enable the Company to continue its business

at least for a period of six or seven months, in the last analysis, the question of fraud becomes unimportant; or, to put it another way, so long as the parties intended by what they did to enable the Company to continue its business, the transactions cannot be said to have been had for the purpose and with the intent of defrauding these Intervenors.

The case last mentioned was favorably commented upon by this Court in *Coler v. Allen*, 114 Fed., 609, where, among other things, this Court held that:

> " A corporation, so long as it is a going concern and engaged in the active prosecution of its business, may lawfully execute a mortgage on its property, if done in good faith, to secure an extension of a prior indebtedness and further advances to be used in its business, *although it is at the time financially embarrassed, or even insolvent;* " and such mortgage could not be set aside at the suit of a judgment-creditor of the corporation.

Speaking through GILBERT, J., among others things, the Court said:

> " The courts of the United States in dealing with the question of the right of an insolvent corporation to prefer a creditor have in all cases, except where the matter is the subject of statutory regulation, held that the corporation had the same right and authority to make such preference that an individual would have. * * *
>
> " This is not the ordinary case of an insolvent corporation selecting one creditor to whom it owed an antecedent debt and securing the same to the exclusion of others. The mortgage in the case at bar was taken not only to secure a prior indebtedness, but a large proportion of the amount secured was a new consideration, money to be advanced for the use of the corporation in its business to the amount of $10,000. The corporation had not to any extent closed its business, *nor is it alleged that it was embarrassed further than that it was insolvent.* Its business was not brought to a close until several months later.

> * * * The mortgage in this instance, according to the pleadings, furnished the corporation funds for its use in the course of its business. His mortgage was taken for money already advanced and for money thereafter to be advanced. It is not alleged that he had any knowledge of the insolvency of the corporation or that the officers of the latter *intended to give him a preference or to hinder or delay other creditors.* The corporation was a going concern. At the time of giving the mortgage and receiving the advances it was apparently preparing for the annual run of salmon which might be expected to furnish it the means of discharging or reducing its liabilities. * * * We think * * * that the appellant has shown no grounds sufficient to justify a decree setting aside the mortgage."

Applying to the case at bar the views there expressed, can it be justly contended that the extremest view of the transactions in question can reasonably be other than that, in consideration of the Railway Company or the syndicate or the Bankers supplying the Power Company with funds sufficient to enable it to continue its plan of improvements and work of construction during the following six months, the Power Company agreed, assuming the worthlessness of the second mortgage bonds, to secure to some extent the moneys theretofore borrowed or, assuming only that the first mortgage five per cent. bonds were then considered to be more valuable than the second mortgage bonds, to increase such security; and if that was the substance of the transactions, regardless of their form, are we not brought directly within the scope of the well-settled law as expressed by this court in the case last mentioned? The only possible difference in the facts is that, the Railway Company directors here who may be compared to the mortgagee there, did know or were chargeable with knowledge of the condition of the Power Company, whereas in the Coler case, it was not alleged that the mortgagee had such knowledge. That however, was not the determining factor, which was and is and should be, whether or not the security was taken or the money advanced in good with faith the intent and expectation of assisting the Company to continue its business. The latter was the

situation in the Damerin case, *supra*, which was cited with approval by this Court in the Coler case; that is, in the Damerin case, the Court expressly found that "the corporation was insolvent to the knowledge of its officers," and one of the mortgages was given to a bank, two of the directors of which were also directors of the mortgagor; and there no new money was advanced and the only consideration given was that of refraining from proceeding against the Company in return for obtaining the security.

Clark and Marshall on Private Corporations, § 777*b*, say:

> "The doctrine which disqualifies directors of a corporation from binding it by a contract or conveyance with or to themselves, or in which they have an interest adverse to that of the corporation, does not, of itself, give the creditors of the corporation the right to attack such a transaction in any case in *which the corporation or its stockholders could attack it.* The transaction, if the corporation was solvent at the time, is not void, but merely voidable at the option of the corporation or its stockholders. Creditors cannot attack it merely on the ground of the fiduciary relation existing between the corporation and the directors, regardless of the fairness or unfairness of the transaction, but, in order that they may impeach it they must show that the corporation was insolvent at the time of the transaction, or that it was entered into with intent to hinder, delay, or defraud them."

And at § 787*a*, they say,

> "So long as a corporation is solvent, it may borrow money from or otherwise contract with an officer or director, and may pay him, or mortgage or pledge property to secure him, just as it may pay or secure any other creditor, and, if it afterwards becomes insolvent, the conveyance, mortgage, or pledge will be valid as against other creditors, although the result may be to leave them unpaid."

As we hope that we have shown, the question is not necessarily affected by the fact that at a shorter or longer time in

the future, as the case may be, the particular corporation confesses insolvency, as ultimately occurred in all of the cases to which we have referred. The receiver of the Power Company was appointed in December, 1913. The Company, however, defaulted on its first mortgage bonds on April 1, 1913, somewhat more than six months after the September transaction and somewhat more than three months after the December transaction. Confining our statement to the December transaction, unexplained, it might perhaps fairly be argued that, at the end of December, 1912, the directors of the Power Company should have had some notion as to whether or not the Company's interest would be provided on April 1st. Undoubtedly, they did have some information on the subject, and, beyond question, at that time there was every intention of continuing to supply the Company with funds.

The record discloses, however, that, intermediate the transaction in December and the 1st of April, a new and disastrous condition in the power market in Boise had come to pass (pp. 431, 432). A company known as the Beaver River Power Company had, in December, commenced actually to serve current in the City of Boise. Prior to that time, the base rate of the Power Company was fifteen cents per kilowatt hour. The rates under which the Beaver River Company solicited contracts were nine cents per kilowatt hour, a decrease of about 40%. Although the facts showing the effect of this competition upon the earnings of the Power Company and the necessity for that Company, in self-protection, to cut its rates to meet the competition were not gone into at the trial, because the question of the Power Company's insolvency or its effect were not presented by the pleadings, in view of the deficit shown for the year ending December 31, 1912, the Court will not be required to indulge any violent assumptions for the purpose of concluding what was the situation at the end of March, 1913. Not only must the Power Company then have lost many of its customers but its proportionate income from those retained must have been very largely reduced. The intentions of its friends in December, 1912, with respect to supplying it with funds to continue its business cannot, therefore, in any extent or to any degree, be made the measure of their intentions, as

disclosed by their acts, three months later. That is not all, however. Obviously, the Power Company was maintained as a going concern until December, 1913, when, by reason of the litigations precipitated by these Intervenors, all parties in interest ultimately consented to the appointment of a receiver. Just as obviously, the Company could not have maintained itself during that period unless it had received further advances of money. Indeed, the opinion and decree herein show that it did receive further advances of money, as security for which the Railway Company interests did not, *as they might have done*, exchange the remaining 107 first mortgage five per cent. bonds for other second mortgage bonds, but received them as security only and did not, as they might readily have done, call the new loans and sell the security, which, after the default in the payment of interest on those bonds, would probably have brought little or nothing and could therefore, have been taken over by the Railway Company at small cost. In other words, despite the inability of the Power Company to pay the interest on its first mortgage bonds, despite its inability to pay the interest on its second mortgage bonds, all of which, except $166,000, were held by the Railway Company, the Power Company was maintained as a going concern during a period of nine months succeeding the default on the first mortgage bonds and a period of eight months succeeding the default on the second mortgage bonds and was, ultimately, placed in the hands of a receiver, not by those who had obtained the alleged benefits of the transactions of which complaint is here made, *but at the instance of these Intervenors.*

Eliminating the fervid rhetoric which constitutes a large part of the Intervenors' Bill, their real reason for coming into the foreclosure suit and precipitating these contests, was that they considered that the plan of reorganization, which had been promulgated by the New York Committee, was unfair to them as the holders of the Power Company's first mortgage bonds. Were we permitted to indulge in prophesy, it would be interesting to speculate as to the ultimate realizations of their bondholders as compared to the plan which the New York Committee formulated for the purpose of seeking to protect them. We have no intention of going into a discussion of

the merits of the plan. As, however, copies of some of the papers connected with it are attached to the Intervenors' Bill we may, perhaps, be justified in pointing out that the plan contained in Exhibit B (pp. 80–89), was not that which was in process of attempted execution, when the Intervenors filed their bill, but that which is set forth in Exhibit C to the Bill (pp. 92–95). Personally, in view of the expressions contained in the opinion of the learned trial court regarding the utter and hopeless insolvency of the Power Company in September and December, 1912, we should be greatly pleased if this court will read the two plans for such light and such inferences as may be deduced therefrom bearing upon the intent of the Railway Company interests at the time of the transactions hereunder attacked. It is believed that, to the extent that the facts are contained in this record, it will be found that the circulars mentioned exhibit to those interested in the Power Company's property an absolutely truthful and straight-forward statement of the facts of the situation at the end of March, 1913, which the bondholders should have considered for the purpose of adequately determining the best course to adopt toward the protection of their own interests. Among other things, it will be observed, that the Railway Company was proposing to cancel this $718,000 of the Power Company's first mortgage five per cent. bonds; that the first proposal of the New York Committee was that the other Power Company first mortgage bonds be exchanged for an adjustment mortgage bond of equivalent amount and that, in addition thereto, the Railway Company issue to each bondholder twenty-five per cent. face amount of its common stock for each $1,000 bond. Not only this, but the Railway Company offered to cancel all of its $854,000 of the Power Company's second mortgage bonds, all of the $250,000 of notes which represented the moneys advanced under the transactions here involved and also to surrender the $500,000 of second mortgage bonds held as security therefor. Not only this but, as the circular states, "as further consideration for the transfer of the property of the Oregon Company, *the Railway Company will, as the same shall be required, furnish for the purposes of the properties now held by the Oregon Company additional capital to the extent of $1,250,000*" (pp. 84 and 85). The circular further states that,

as appears from the figures given, if the transaction were consummated as proposed, the Power Company's properties would have cost the Railway Company $4,316,000 face value in bonds and notes.

In addition to setting forth all of the figures which might properly enable the bondholders of the Power Company to determine their best interests, the circular set forth clearly and in detail all of the properties owned by the Railway Company, and the securities which were outstanding against them (pp. 85-87). The circular also proposed that the adjustment bonds should only receive interest as earned, and estimated, on the basis of then current earnings and " under the present severe competitive and cut-rate conditions existing in Boise and the neighborhood," that the adjustment bonds would show interest of approximately four per cent. during 1913, five per cent. during 1914 and six per cent. during 1915, whereas, under the same conditions, it was estimated that the earnings for the first and refunding bonds then held by the Power Company bondholders (those held by the Intervenors here), would be sufficient only to pay at the rate of 2.4 per cent. during 1913, two and 2.8 per cent. during 1914 and 3.6 per cent. during the year 1915 (p. 87).

The circular also pointed out that the bondholders must consider " that, unless the work of the Ox Bow is completed with reasonable diligence, the Company's rights there will abate and its entire investment therein will be lost," which investment at that time represented bonds to the aggregate amount of considerably more than $2,000,000 (p. 87).

The foregoing statement was followed by this :

> " As it is apparent that some definite course of procedure must be adopted at once, the only alternative to the plan proposed *would seem to be for the bondholders to take over the property and themselves finance its development* " (p. 88).

In addition to the foregoing, the circular also informed bondholders that the Committee would arrange to procure funds with which to pay the April 1st coupons from the bonds of those who assented to the plan " and that depositors will

not be called upon to bear any part of the expense of carrying out said plan " (p. 88).

In view of these provisions, in all fairness and in an appeal to a court of conscience, particularly in face of the views expressed by the learned trial court with respect to the value of the Power Company's properties, will any sane and reasonable man be able to say that those controlling the Railway Company had any intent, purpose, desire or design other than to do what was possible to maintain the Power Company as a going concern? Would they, otherwise, have consented to the cancellation of securities and notes aggregating $1,882,000, all of the security held for their notes, and have obligated themselves to supply additional funds *for the development of the Power Company's properties* to the extent of $1,250,000, with any view to wrecking the Company or doing otherwise than improving its situation and increasing its value? Had the plan been made operative, if the estimates therein made were justified, instead of being barren of interest on their investment since April, 1913, the bondholders would have been receiving a small return which, by this time, if the then earnings had continued and increased as expected, would have amounted to the original rate. Whatever other conclusion may be drawn from the matters last herein mentioned, can they be said to be significant of an intention in September and December, 1912, of terminating the business of the Power Company and of making away with such of the wreckage as was possible?

The Intervenors may respond to these suggestions by the statement that, as subsequent events disclosed, the Railway Company was not financially able to carry out the plan and to advance the additional moneys proposed. The rejoinder is that the financial ability of a Company of that character is measured by its credit. That credit was maintained until December, 1913, and until after the actions of the Intervenors had forced the appointment of a receiver of the Power Company. There is no suggestion that those interested in the Railway Company were not able to carry out their plan for the consolidation of the two companies and to supply the Power Company with the additional funds necessary to develop its potential resources; and the fact that they sustained the Power Company during a period of nine months following the default

upon its first mortgage bonds can, we most earnestly submit, be held to be significant only of a most sincere and determined resolution to do everything possible to prevent those now represented by these Intervenors, and the two properties themselves, from getting into the position in which they now find themselves.

We also earnestly hope that the Court may read Exhibit C of the intervenors' Bill, which is a circular to the holders of both classes of the Company's bonds and to its stockholders, in which is set forth a modified plan of reorganization. The circular mentions that, since sending the previous circular (Exhibit B),

> " the Committee has received from various parties in interest and considered a great variety of suggestions and proposals. During the past two weeks, at the invitation of the Committee, its representatives and those of other parties in interest, including those who have sold the Idaho-Oregon Company's bonds, have conferred almost daily regarding the matter ; and, in connection with their consideration thereof, all desired facts bearing upon the situation have been furnished from the records of the Idaho-Oregon Company and of the Railway Company. As a result of such conferences another plan has been prepared, a copy of which is herewith enclosed. As you will observe, the plan now includes the holders of the Consolidated First and Refunding Mortgage 6% Bonds, as well as all preferred and common stockholders of the Idaho-Oregon Company " (p. 92).

The circular continues (p. 93) :

> " Instead, as originally proposed, of an adjustment bond paying interest only as earned, the Railway Company will create a second mortgage covering all of its property, rights and franchises and all of those now held by the Idaho-Oregon Company, to secure bonds which will be issued in two series, to be designated respectively ' A ' and ' B '.
>
> " Series A bonds will be issued to the amount of

> $3,212,000 and will bear interest at the fixed rate of 2% during the first, 3% during the second, 4% during the third year and 5% thereafter. *In addition, they are to be convertible into first mortgage bonds of the Railway Company, par for par, after five years,* in amounts of not less than $500,000, under the conditions more particularly set forth in the said amended plan."

It will be recalled that $3,212,000 was the aggregate of all of the first mortgage bonds of the Power Company outstanding, including the 718. Thus, instead of an adjustment bond paying interest as earned, those represented by the Intervenors were offered a bond with a definite lien and fixed interest rate which, after five years, would be convertible into first mortgage bonds (pp. 93 and (3) 94).

It will also be observed from the modified plan that excluding the $718,000 of bonds, the securities held by the Railway Company were to be made subordinate to those representing the bonds held by the Intervenors and other Power Company first mortgage bondholders, and that Series B bonds in the proposed consolidated company were to be accepted therefor (pp. 93 and (5) 94); also that all of the outstanding second mortgage Power Company bonds were to be exchanged for Series B bonds ((4), p. 94). The Series B bonds were to be entitled to "no interest during the first three years after their issue unless and to the extent that the same shall be earned;" and that, in such event, the interest was to be limited to 5%.

Again we ask, do these suggestions indicate a desire or intention on the part of the Railway Company interests to throttle or defraud those then holding the securities of the Power Company? Do they indicate any campaign based upon the right of might and do they suggest any invitation for him to take who can? To be sure, the moneys then invested in the Railway Company's properties were to be secured by a prior lien on the combined properties, but those who had invested such money were agreeing to invest further large sums for the benefit of the properties of the Power Company which, necessarily, would have greatly enhanced their value and increased their capacity. To the extent that they also had invested in the Power Company, not only did they not suggest

any preference, but that they subordinate their obligations to those of others who had invested in the Power Company's securities. At that time, with the severe competition existing in Boise, it had become obvious that, without the strongest possible assistance, the business of the Power Company was doomed. Do not the facts, in view of such circumstances, justify the assertion that the Railway Company interests were actuated by a desire to do everything possible for the Power Company's bondholders, although they had not been responsible for the sale of one dollar of its securities? Not only did they offer to provide the means of strengthening the properties of both companies, but their plan provided that at the end of five years, assuming of course a proper increase in the earnings of the Company, the investment of the Power Company's first mortgage bondholders, other than their own, should be placed upon a par with their investment in the Railway Company.

In the light of subsequent events, perhaps, the Railway Company interests should express their gratitude to the Intervenors because their machinations rendered their plan of reorganization impossible of consummation! It would seem, however, to be a matter of grave doubt if they are also entitled to the gratitude of those whom they are assuming to represent. Be that as it may, we confidently assert that, so far as they are disclosed by this record, the entire sequence of events following the transactions of September and December, 1912, fails to indicate any intention, desire or expectation on the part of the Railway Company interests that the Power Company would cease to be a going concern; that any occasion would exist for collecting the wreckage from its destruction, and that such terms are justified in connection with the present situation of the affairs of the two companies only because of the destructive activities of these Intervenors.

We will close this portion of the discussion by reference to Wilmott v. London Celluloid Company, Law Reports, 34 Chancery Division, 147, which is most instructive. There, B. and H., who were directors of the Company, B. being Managing Director, had advanced it moneys from time to time. In September, 1884, the Company's plant was burned and the Insurance Company had admitted liability to pay £3,000 on

account of the loss. Two directors constituting a quorum, B. and H. immediately held a directors' meeting and adopted resolutions authorizing actions to be begun at once against the Company in their behalf for the moneys which they had loaned and authorizing and instructing solicitors to immediately appear for the Company and consent in its behalf to judgment. The actions were brought, judgment taken immediately by consent, garnishee orders served on the Insurance Company, the £3,000 obtained and applied upon the debts due from the Company to themselves. It also appears that, although the Company's business was continuing, it was at the time, insolvent.

The Company had issued mortgage debentures, which were a first charge upon all of its property, both present and future, except that "the company might in the course of its business deal with the property charged in such manner as the company might think fit." In December, 1884, the debenture holders brought an action against the Company and against B. and H. for the repayment of the £3,000 and for other relief. Two days thereafter, an insolvency petition was presented and a winding up order was shortly made. Held, that there was no fraudulent preference to B. and H. and that the transaction complained of, *being in fact the payment of a just debt while the Company was still a going concern, was* a dealing by the Company in the course of business within the condition of the debentures.

In the course of the argument, counsel for the debenture holders, said :

> "It cannot, perhaps, be said that the Company was doing no business at all ; but all its machinery, and the greater part of its stock, had been destroyed by fire, its landlord was pressing for rent, the company was *in extremis*, and practically was not a going concern. And inasmuch as the effect of this transaction was not to enable the company to continue its business but to bring the business to an absolute standstill, it cannot be considered as one in the course of business, which must mean in the course of the ordinary business of the company as a going concern."

In considering the matter, Cotton, L. J., *inter alia*, said :

> " It is unnecessary to give any opinion as to the conduct of the defendants in this matter ; the question is, whether they were acting in the course of the business of the Company. * * * The Company, of course, means the directors, and the resolution complained of was passed at a meeting of directors at which a proper quorum was present * * *. The plaintiff has not made out that the business of the Company had stopped at the date of this transaction, *although undoubtedly the Company was at that time insolvent ;* and I think we must hold that until the presentation of the winding-up petition the business of the Company was going on. That being so, this dealing must be considered to have taken place in the course of the business of the Company, and therefore, * * * the plaintiff's claim cannot succeed."

Sir J. Hanan, among other things, said :

> " No doubt, considerable prejudice has arisen as to this transaction from the circumstance that the two directors who acted in the matter were interested parties. But considering the transaction without prejudice, it appears to me that the question is whether or not the payment of a legitimate and just debt is in the course of the business of the Company, and, so put, the question answers itself."

Fry, L. J., expressed the same view.

Assuming that, if the transactions here under review can be said to have taken place in connection with the usual course of the transaction of the Power Company's business, they cannot be held fraudulent as to the Intervenors, will any unprejudiced mind conclude that the stipulation of the Railway Company for better security in connection with the agreement to make an additional loan of $250,000 is, morally or equitably, more reprehensible than the actions of the two directors in the case last quoted, who alone constituted the meeting of the Board at which arrangements were made whereby their per-

sonal claims for monies *theretofore* advanced to the Company were to be paid, notwithstanding that their Company was in fact insolvent and, by the destruction of its plant, had lost its capacity, for the time being at least, to carry forward its business and to seek to recoup its losses? If any dealings between a corporation and its directors can ever be said to give creditors, who were not thereby intended to be defrauded, any right of action, it would seem that a more flagrant case can hardly be imagined. As one of the judges there said, because the directors while representing the corporation, had dealt with themselves, "No doubt considerable prejudice has arisen as to this transaction." Such prejudice will not, however, affect this Court, which is wholly removed from the atmosphere of the subsequent difficulties of both of the Companies involved, and we have little doubt but that, as the Court in the Willmott case said, when they are considered without prejudice, the conclusion here will be the same.

V.

The rights of the Intervenors are confined to their contract, which has not been violated.

If we are correct in the conclusions expressed in the foregoing portions of the discussion, the decree below must be re versed because, (*a*) within the rule entitling creditors to attack corporate transactions, the record either discloses that the Power Company was wholly solvent, or, that issue not having been presented by the pleadings, an opportunity to meet it should be afforded the respondents; that (*b*) if we are in error in those contentions, the record negatives any conclusion of an intent to defraud these creditors, which is the only character of fraud of which they may complain, and (*c*) that the issue of an intent to defraud the Intervenors is not presented by the pleadings and is not, therefore, before the Court.

The brief in behalf of the Receiver of the Railway Company points out that transactions between a corporation and its directors are not void but only voidable at the instance of some one entitled to act in behalf of the corporation. Strictly speaking, that question is not presented here because, clearly, as creditors, the Intervenors have no right whatsoever to act in the Company's behalf. *The question is not if the Company was defrauded, but have these Intervenors been defrauded* which, as we have attempted to show, is a wholly different thing. The burden of proving the fraud is upon the Intervenors and cannot be shifted by the easy method of considering the case as though the respondents were presenting their bonds on distribution and requesting payment thereof, as the learned trial Court seemed to consider. Thus the opinion states :

> " The Railway Company is in reality the actor. It is not content with what it was thus wrongfully able to acquire through its control of the Power Company. It is dependent upon, and is here invoking, the assistance of a court of equity to make actually available to it the fruits of its wrong-doing * * *. It is asking the Court to aid it in enforcing contracts the possession of which it obtained in a manner violative of sound principles of public policy and of good morals, and in that view it is quite unimportant whether the intervenors would have any standing as plaintiffs in an independent suit. Regardless of who objects or whether any one objects, a Court will not knowingly assist a party to realize the fruits of his wrong-doing, and under the rule the Railway Company must be denied the relief which it seeks."

Notwithstanding that the apparent indignation of the Court has carried it to such lengths, we respectfully submit that such views should not override the requirements of the rules of evidence and other rules of orderly court procedure. Had this controversy actually arisen after the sale of the property, the bonds held by the Railway Company, which are payable to bearer, would have been presented in due course to the Master, which presentation would have raised a presumption

in favor of their participation in the distribution of the proceeds of this sale. If any one should object to such participation, it would be necessary for him to justify the objection and, if it were based upon the ground that the bonds had been fraudulently obtained, the burden would have been upon the objector to make proof of his allegations. The changed and imaginary situation upon which the Court lays hold for the purpose of justifying its conclusions cannot, in the last analysis, be made to deprive the Railway Company of any of its rights, nor can it change any fundamental principles of law. Accordingly, regardless of the actual or imagined conditions under which the question arises, unless the Intervenors have made clear proof of the intent of the Railway Company interests to defraud them and unless that issue was tendered by their Bill, the decree is wrong, fundamentally and grievously wrong; and it cannot be made right by any shifting or assumed or pretended changing of the situation.

Without again citing or again quoting authorities to which we have heretofore referred, it is obvious that a creditor's claim against a corporation must, like every other legal claim, be grounded upon contract or tort. The claims of the Railway Company here are based upon contracts, which, in the case of that of September, 1912, has been fully executed by both parties thereto, and, in the case of that of December, 1912, has been fully executed by the Railway Company and has been executed by the Power Company to the extent of exchanging 218 of the first mortgage 5 per cent. bonds of the 500 which it thereby agreed to exchange. Accordingly, under the conditions assumed by the Court, these 718 bonds have been presented to the Master claiming their distributive share in the proceeds of the sale. The Intervenors object and as a ground of objection assert that the Railway Company should not participate in the proceeds of the sale because it acquired the bonds by taking advantage of its influence over the Power Company. The Railway Company responds that the assertion is untrue, but, whether true or not, it is not the affair of the Intervenors, whose bonds were issued under the terms of the mortgage of April 1, 1907, each of which states that each bond is one of a series "of like form, tenor and effect" amounting in the aggregate to $7,000,000, the payment of all of which, with interest, "is equally and ratably,

and without preference of one bond over another, secured by a trust deed or mortgage", etc., "which trust deed is made a part hereof" (pp. 383 and 384); that, after describing the property, the mortgage or deed of trust provides that the conveyance is

> "in trust, however, for the equal and proportionate benefit and security of all present and *future* holders of the bonds and coupons issued and to be issued under and secured by this indenture, and for the enforcement of the payment of said bonds and coupons, when payable, * * * without preference, priority or distinction, as to lien or otherwise, of any one bond over any other bond by reason of priority in the issue or negotiation thereof, so that each and every bond issued and to be issued as aforesaid shall have the same right, lien and privilege under this indenture, and so that the principal and interest of every such bond shall, subject to the terms hereof, be equally and proportionately secured hereby, as if all had been made, executed, delivered and negotiated simultaneously with the execution and delivery of this indenture; it being intended that the lien and security of this indenture shall take effect from the day of the date hereof, without regard to the date of actual issue, sale or disposition of such bonds, and as though upon the day of such date all of said bonds had been actually issued, sold and delivered to, and were in the hands of innocent holders for value" (p. 386).

The Railway Company further shows that the mortgage also provides that the bonds issued thereunder shall not become obligatory until they shall have been authenticated by the certificate of the Trustee endorsed thereon. Other provisions follow, referring to the use to be made of bonds of specified amounts (pp. 387 to 390). Of such bonds, Nos. 2501 to 3050 inclusive, were set apart for the purpose of paying off and retiring underlying bonds covering the properties of the Electric Power Company, Ltd., and the Boise-Payette River Electric Power Company. Of these, the Railway Company

holds $24,000, face value, being Nos. 2501 to 2514, inclusive, and Nos. 2525 to 2534, inclusive (p. 397).

The mortgage further provides that the remainder of the bonds, being Nos. 3051 to 7000, inclusive, shall be held by the Trustee until certified and delivered to the Company from time to time for (*a*) the purchase or acquisition of other properties, and (*b*) for the payment of outstanding indebtedness secured by lien on any properties thus purchased, and (*c*) "for 90% of such amounts as may be after this date actually expended by the said Company in additions, improvements, extensions, enlargements, equipments or betterments to any of its plants or property now or hereafter acquired" (pp. 390 to 393). All of the remaining bonds held by the Railway Company have been issued under one or the other of the three last-mentioned provisions of the mortgage (pp. 397 to 398).

The Railway Company, therefore, replies in substance that the bonds which it holds were issued under the same mortgage as that which secures the bonds held by the Intervenors were concededly issued in accordance with its terms and provisions ; that the Intervenors are bound by those terms and, therefore, have no standing to contest the right of the Railway Company to participate in the security. The Intervenors rejoin that the Railway Company procured its bonds by fraud ; the Railway Company responds that such fact is of no importance as between the intervenors and the Railway Company, unless the Intervenors show that the fraud was perpetrated upon them and that the transactions were had with intent to hinder, delay and defraud them.

Disregarding all forms of procedure and looking only to the substance of the situation and assuming, for the purposes of argument, that the issues are presented upon application in connection with the distribution of the proceeds of the sale, the foregoing presents the sequence of the claims and counterclaims which lead to the issue which the learned Trial Court has determined (although not presented by the pleadings) and leaves the burden upon the Intervenors to establish not only the fraud but that it was committed upon them. If, in the previous portions of this brief, we have disposed of that issue favorably to the Railway Company, it is unnecessary to proceed further. From our point of view, however, the matter can be made so perfectly clear by considering the contract

rights of the parties, that we have done so, with the result that, both upon reason and authority, it appears to us that unbiased minds should find it impossible to reach divergent conclusions. As we read the opinion of the learned Trial Judge, he was sufficiently impressed with the argument upon this head to himself develop the fraud theory and ultimately to rest his conclusions thereon.

In considering this point, we again call attention to the fact that the record contains no evidence showing when the intervenors became creditors of the Company ; that they acquired a very large proportion of the bonds which they control after their bill was filed, and that it is a general rule of law that one who becomes a creditor of a corporation after the acts of which complaint is made has no standing to attack such acts.

Toledo, etc., R. R. Co. v. Continental Trust Co., 95 Federal, 497.

It is obvious that the only classes of persons, who, by any chance, can have any interest in the transactions in questions are,

(*a*) Stockholders of the Power Company,

(*b*) General creditors of the Power Company,

(*c*) Holders of the First and Refunding Bonds,

(*d*) Holders of the Consolidated or Second Mortgage Bonds.

Taking up these *seriatim*, one of the Intervenors' assertions is that, since the Railway Company held practically all of the capital stock of the Power Company, stockholders could not complain. Discussion under this head is bootless, however, because, to the extent that the Railway Company controlled the stock of the Power Company, it was, of course, entitled to ignore its rights in that regard in any manner that it saw fit.

As no general creditors are complaining, no purpose can be served by considering their rights or interests.

In this connection, however, we deem it pertinent to make further reference to the opinion of the learned Trial Judge for the purpose of disclosing the extent to which, in determining these particular issues, he found it impossible to

limit consideration thereof to this particular record. Thus, his opinion states (p. 150):

> "From what fund the certified expenditures on account of capital were made does not appear (this statement is erroneous, as we shall hereafter show), but that for the protection of their security they were interested in having these bonds honestly used for the benefit of the estate becomes apparent, *when the fact is noted, as shown by the record here, that preferential claims for labor and supplies, for the maintenance and operation of the property, aggregating an amount relatively of great magnitude, are being* ~~*approved*~~ pressed *for allowance,* in *at least one of which the Railway Company itself is* ~~*pressing*~~ interested, *and which, if established, will substantially reduce the value of the intervenors' security. These and other considerations* strongly persuade me to the view, etc."

So far as we can ascertain, the claims to which the learned Judge refers are not shown by the record here, yet he states in so many words that the fact of their pendency persuades him to the views which he expressed. Though the preferential claims mentioned were a part of this record, it is incomprehensible to us that their assertion can or should in any manner affect the conclusions to be here reached, except insofar as they might tend to suggest that, if allowed, a deficiency would exist in the security of the First Mortgage Bondholders. Mention of their existence in that connection was unnecessary, however, because, in his entire opinion, the Court had assumed that such a deficiency would result and, in order that the issues might not be unnecessarily clouded, counsel for the Railway Company's Receiver had, at the trial, apparently acquiesced in that assumption. If the preferential claims are valid, they will, of course, be allowed; if invalid, they will not be allowed. Their allowance or disallowance can, however, have no effect upon the fundamental questions here at issue because, whether or not the contracts of September and December, 1912, had been made, *non constat* but that the preferential claims would have existed, and their magnitude and the principles upon which they will be allowed or disallowed have not, so far as

can be judged from any evidence in this record, been affected by the contracts under consideration.

Of the parties possibly interested in these issues, there is left, therefore, the holders of the bonds issued under the two mortgages. As all of the Second Mortgage Bonds except $166,000, the holders of which do not complain, are held by the Railway Company, it is apparent that the Railway Company combined in itself practically all classes of rights and claims which are affected by the questions involved herein, except the First and Refunding Bonds.

Regardless of all questions of insolvency and fraud, what, then, were the rights of such Bondholders? Surely in the absence of any fraud practised directly upon them, they must be found within the four corners of the contract or contracts which they have made. These contracts are set forth in the bonds and in the Trust Deed or Mortgage which secures them, the material portions of which have hereinabove either been quoted or called to the attention of the Court. The only fiduciary relationship involved in these contracts is that which the mortgagee or trustee assumes. So far as the mortgagor and the bondholders are concerned, the relation is solely that of debtor and creditor and is wholly measured by the terms of the contract. As no claim is here made against the Trustee under the mortgage, there remains for consideration only the relationship of the mortgagor and the bondholders.

The principal stipulations of the contract concern the aggregate of the obligations which the Company is entitled to create thereunder, the security which the holders of the bonds are to receive, the rate of interest which is to be paid, and the time and manner of its payment, the duration of the obligations, and the rights of the holders of the bonds in case of default. Practically all additional provisions of such instruments deal with some detail of these principal points. As modern business conditions are becoming more complex, the elaboration of such details is becoming more pronounced. Many provisions now found in such instruments are of recent evolution and, for that reason, have not yet undergone conclusive judicial construction. Among these are clauses entitling the mortgagor to increase the aggregate of bonds outstanding in some proportion as the value of the property com-

ing within the lien of the mortgage increases. These provisions are, however, just as much a part of the contract between the mortgagor and the bondholders as any other provisions of the bond or of the mortgage and the respective rights of the parties, insofar as they relate to such provisions, must be determined thereby.

We have already pointed out the provisions of the contract under which all of the bonds were to be issued, have called attention to the fact that the Power Company has scrupulously adhered to their terms and that, accordingly, the bonds here in question were issued only after the security for those held by the intervenors had been increased in the manner and to the extent stipulated. Thus, with the exception of $24,000 thereof, which were issued to reimburse the Company for monies expended by it in retiring an equivalent amount of underlying bonds, and $52,000 thereof issued in connection with the purchase of additional plants and property, all of the bonds in controversy were issued for 90% of the sums expended by the Power Company for improvements and betterments. In other words, 652 of the 718 bonds were issued for 90% of the sums expended for improvements and betterments. This means that, before these bonds were certified, the intervenors' security had been enhanced as follows:

Cost of improvements and betterments	$724,445
Underlying bonds paid	24,000
Additional plants and properties purchased	52,000
Total	$800,445

The total number of First Mortgage Bonds outstanding, in addition to the 718, is $2,494,000. In other words, from some source, the security of the intervenors and other bondholders had, before these bonds were issued, been increased to the extent of substantially 33⅓%. If, prior to the issuance of these bonds, their security was adequate, surely the issuance of $718,000 of bonds against property of a cost value of more than $800,000 did not depreciate that security, while if the security was then inadequate, it was increased to the extent of the proportionate interest of the other bondholders in $72,445, which measures the difference between the cost of the betterments and im-

provements against which a part of the bonds were issued and the face amount of the bonds issued against the same. It is clear, therefore, that, upon no possible theory can the issuance of these bonds be shown to be detrimental to the interests of the bonds represented by the intervenors, unless they are to be given the benefit of the expenditure of more than $800,000, supplied by others than themselves, to which they did not contribute one penny. That, in its baldest terms, is the position of these intervenors. If it be equity, having in view the contract obligations of the parties, we confess that we are unable to understand what may properly be termed iniquity.

The great difficulty of the Trial Court was that, subconsciously, he was affected by conditions obtaining at the trial of these issues, whereas the validity or invalidity of the transactions must be determined as of the time when they took place. They were then legal or illegal, proper or improper, fraudulent or not fraudulent ; and, except insofar as they may properly influence the conclusion as to the intent of the parties at the time, subsequent events must be entirely disregarded.

Suppose that the underlying bonds represented by $24,000 of the $718,000 in bonds had never been retired ; that the plants represented by $52,000 of the bonds had never been acquired, and that the betterments and improvements costing $724,000 had never been made. Obviously, this controversy would not have existed. In that event, however, does any suggestion or fact in the evidence affirm that the intervenors' bonds would, proportionately, have been better secured than is the case under existing conditions, and with the 718 additional bonds outstanding? As above stated, is not the only reasonable conclusion from the facts that, because of the 90 per cent. clause, such bonds are now better secured and, therefore, that the intervenors will realize more thereon than though the property represented by the 718 additional bonds had never been acquired? And if these inquiries must be answered in the affirmative, upon what possible theory can these intervenors have been disadvantageously affected by the issue of such bonds ?

The intervenors pretend to appeal to a Court of Equity on the broadest grounds, yet the substance of their appeal is that the Court give them the advantage of the expenditure of more

than $800,000 of others' monies and their assertion is that, unless that appeal be granted, forsooth, a fraud will have been done them. Is it possible that such a position can stand the test always applied by a Court of conscience? If so, truly things are becoming topsy-turvy, and, it would seem to us, too much conscience, if not too much learning, is making some of us mad.

Without again referring to the particular language of the contract providing for the issuance of these bonds, its intent appears to us to be perfectly clear and, therefore, to be susceptible of no misconstruction. Its effect is that by complying with the required details, whenever the Company desired to retire any underlying bonds, it might issue for the purpose First and Refunding Bonds of a face amount equivalent to those to be retired; that whenever the Company acquired or desired to acquire additional property, by complying with the details prescribed in that connection, it might issue under said mortgage bonds of a face value equivalent to the value of the property acquired or to be acquired, and that whenever it had made expenditures for improvements and betterments to to an amount greater than the face value of any of the unissued bonds, by evidencing such expenditures to the trustee in the manner stipulated, additional bonds might be issued to the extent of 90 per cent. of such expenditures. The language is so plain and comprehensive that no discussion of these provisions of the contract is required for the purpose of demonstrating that everyone who acquired a bond secured by the mortgage agreed in terms that additional bonds, issued as therein prescribed should, so far as concerned sharing in the lien or security of any and all property at any time covered by the mortgage, be upon a plane of equality with that of his own bond.

Such being the contract, if it is observed by the mortgagor, what possible interest has any bondholder in the use which is made of any other bond, after its proper issue? The holder of the first bond disposed of by the mortgagor understood clearly that, up to the limit provided by the contract, upon compliance with its terms, additional bonds could be issued; and the holder of each bond subsequently disposed of accepted the same with a similar understanding. Accordingly, by accepting the bonds which they hold, each and all of

the intervenors agreed that the 718 bonds might be issued by the mortgagor at the times and under the circumstances and conditions which surrounded their issue. Having made that agreement, since it compasses their entire rights in the premises, upon what possible contract theory can they exert rights beyond the terms of their contract? They concede that the trustee has observed all of its duties toward them in connection with the issuance of the bonds and, therefore, they concede that the mortgagor has received and placed under the lien of the mortgage all of the additional assets which it agreed with them that it would receive and subject to such lien before the additional bonds were issued. Having thus exactly performed its agreement with them, how can they be heard to complain with respect to any disposition of the bonds by the corporation, when they agreed that it might issue them as soon as their security was enhanced to the required extent?

Cannot the question be reduced to its simplest form by satisfying ourselves as to the ownership of the bonds when they were certified and delivered to the mortgagor? Surely no justification exists for any claim that they were the property of the intervenors; and can anyone suggest any theory upon which they could have become the property of any other than the mortgagor? Having become its property, were they, while in its possession, impressed with any trust for the benefit of anyone and, if so, for whom? Having fully performed its contract with the intervenors, what possible basis is there upon which can be raised a claim that, when the bonds were issued to the mortgagor, they were received by it charged with any trust in behalf of the intervenors?

If trust there were, how do we discover the beneficiaries? Having acquired the bonds under a contract with the trustee under the mortgage and with the other bondholders, what different relationship did the mortgagor bear to the property so acquired than to that which it acquired under any other contract which it made in connection with the performance of its corporate functions? Unless there be a response to these inquiries other than that which we have been able to discover, the bonds became the absolute property of the mortgagor, to be utilized by it in furthering its general cor-

porate enterprise, in the same manner and to the same extent as did all other property which it acquired. In the last analysis, is not the response of the intervenors to these propositions only that the Power Company sold the bonds at too low a price? And if this be the situation, are the rules which determine the rights and liabilities following such a disposition any other or different than those which determine the rights and liabilities following the disposition of any other corporate property?

If our reasoning to this point is accurate, the intervenors have no claim against the Railway Company, because the contract with them was rigidly observed and they have no rights beyond its terms. It follows, therefore, that had the bonds been distributed gratis among the directors the rights of the intervenors would not have been affected, and, consequently, they would not have been entitled to contest the title of the donees. We here present the baldest and most aggravated transaction which, short of the commission of a crime, can be imagined in order to illustrate the fundamental nature of the proposition which we are advancing. Lest the suggestion impress the judicial mind as abhorrent, we hasten to add that the intervenors could not have complained of such aggravated dereliction of duty, because they were not harmed thereby, and, therefore, had no interest therein. They are, in no sense, the guardians of the public morals nor of the rights and interests of the mortgagors, stockholders, general creditors or of the other holders of the consolidated bonds, which, together, constitute all of those who could, by any chance, have any interest in such illegal acts of the directors.

Although, upon principle, we could perceive no escape from the soundness of these propositions, at the time of the argument below, although submitting cases which illustrated the principles involved, we were not able to supply the learned Trial Court with judicial authority dealing with a state of facts precisely analogous to those here present, so far as the contract rights and interests of the intervenors are concerned. Fortunately, we are now able to do so in a case which, we are happy to say, exactly supports our reasoning.

> *Bank of Toronto v. Cobourg, etc., Ry. Co.*, 10 Ontario, 376.

This case is so directly in point that we will quote from the report thereof at length, fearing lest the volume itself may not be available to this Court.

At the outset, the report states:

> "The circumstances out of which the present appeal arose fully appear from the judgment of the Master-in-Ordinary, which was delivered by him on January 8, 1885, and was as follows:
>
> "Mr. Hodgins, Q. C., Master-in-Ordinary. The judgment directs an inquiry as to who other than the plaintiffs are the holders of the bonds of the same class of the defendant Company, and an account of what is due to such bondholders.
>
> "These bonds * * * *are declared to be a first charge upon the property of the Company.* The debentures were intended to be issued at a discount, and several of them were so issued, but others were *taken by some of the present holders at par.*"

The Master then states that debentures were issued to three persons named to the extent of $156,000 face amount, out of a total issue of $300,000, and that the $156,000 were issued at a discount of 25%, for "monies obtained by the defendant company on the discount of notes made or endorsed by these parties for the benefit of the company."

> "At the time the proceeds of this discount were received by the Company, the Schoenbergers and Butts (those to whom the questioned bonds were issued) were directors of the defendant Company. * * *
>
> "The plaintiffs contend that these parties * * * as being directors * * * can only claim the amount actually advanced by them to the defendant company; that they could not, as such directors, sell these debentures to themselves at a discount, nor could they claim to hold them at a profit beyond what the company owed them on the notes discounted for its benefit."

After stating that the act under which the debentures were

issued authorized their lawful issue at a discount, the Master continued:

"The Act also makes these debentures *a first charge on the property and franchises of the company, without preferment or priority of any one debenture, so to be issued, over any other debenture so to be issued.* It further gives the debenture holders the right to foreclose. * * *

"The judgment provides for a sale instead of a foreclosure; but that cannot be held to alter the statutory rights expressly given to these debenture holders by the Act.

"The plaintiffs as debenture holders are creditors of this company of the same class as the directors referred to. *There is no fiduciary or trust relation between the plaintiffs and these directors, which would entitle the plaintiffs to invoke the equitable jurisdiction of the Court.* As directors of the company they owed no trust or duty to the co-holders of debentures which would compel them to hold or dispose of these bonds or debentures for such co-debenture holders. These directors obtained a title to these debentures before the plaintiffs became debenture holders. The plaintiffs, therefore, had no beneficial interest or claim in the debentures when these directors obtained theirs.

"All holders stand on the same footing, *inter se*, as creditors of the Company. Each debenture holder knows that he holds part of an issue of debentures for $300,000 *pari passu* with other holders; that they are all alike as to payment, rate of interest, and remedy; that there is no priority among them, and that they are in every way placed on an equality as between themselves.

"The parties whose property is chargeable with, or which may be foreclosed or sold to pay these debentures—the company or its shareholders—*are the proper parties to complain of these directors; but they do not complain.* They, as the *cestuis que trustent* of these directors, are alone entitled to any profit, if profit there be, acquired by them as their trustees.

"No case has been cited to shew that any such

claim of a *cestui que trust* vests in, or can of right be enforced by, the creditors of such *cestui que trust*, as these plaintiffs are. And it is well settled that a trustee's claim against a trust estate cannot be enforced by the creditors of such trustee (citing).

* * * * * * *

" A similar rule prevails in the jurisprudences of the United States.

" The purchase by a trustee of property of his *cestui que trust* is voidable at the option of the latter. But he may affirm the sale, or not impeach it ; and if regular in other respects, it cannot be questioned by third parties on the ground of its being a purchase by a trustee. It is the fiduciary relation to the beneficiaries of an estate which prevents the trustee from purchasing the estate. But a violation of his duty in this respect may or may not be questioned, at the option of the beneficiaries, but not by persons who have not that relationship to the trust estate ; *Baldwin v. Allison*, 45 Minn., 25.

" So where the administratrix of an estate foreclosed (or sold under process of a court) certain lands which had been mortgaged to the intestate, and purchased the lands for herself, it was held that although the sale might be set aside by the heirs, its validity could not be questioned by the creditors of the estate (citing).

" Nor is the assignee of a beneficiary or *cestui que trust* entitled to an account against trustees for a breach of trust, or to apply to a Court to avoid transactions between such *cestui que trust* and his trustee, on the ground of the fiduciary relationship between them ; *Hill v. Doyle*, L. R., 4 Equ.ty, 260 ; *Rice v. Cleghorn*, 21 Indiana, 80. In the latter case the Judge said : ' The purchase of trust property by a trustee is not void, but may be avoided by the *cestui que trust* within a reasonable time, in a direct proceeding for that purpose ; but such a result cannot be effected at the suit of a third person.'

" Nor can one who holds possession of the trust estate, under the *cestui qui trust*, invoke the fiduciary or

trust relation to impeach a wrongful purchase made by the trustee of such trust estate" (citing).

* * * * * *

"Besides, these directors are here as creditors enforcing their rights as such. *Rightly or wrongly*, as between themselves and the company, *they have possession of these debentures as creditors, and this proceeding is not a proceeding to make them account as trustees.* * * *

"In no sense, therefore, can these directors be held to be trustees or agents for the plaintiffs or other co-debenture holders, or bound by any fiduciary or trust relation to account to them for their acquirement of these debentures."

The report then states that the Master fixed the sums due the directors and their representatives, as bondholders, at the principal amount of their claims with interest; and that thereupon, the plaintiffs appealed from the report of the Master, on the ground, as set out in the appeal,

"That the said Master should have found and reported that the said parties were not entitled to rank upon the estate of the said railway company in respect to the said bonds and interest, but if entitled at all they were only entitled to be paid the amounts actually advanced by them to the said company in respect to the same, and the said Master erred in allowing the *said parties to prove as creditors to the full amount of the face value of the said bonds.*"

The report then gives at some length the arguments of counsel; from which it is interesting to observe that, for the appellants, it was insisted that, "If the Master is right, the company might have handed over these debentures as a gift, and yet we could not object because the company is not objecting."

Also that, "We are entitled to say that in the hands of the directors these bonds form no debt against the company at all. At the same time we are willing to concede that they succeed to the extent of the monies actually advanced by them."

The defendants responded to the effect that, "If the company has to raise money to carry on its business, and if it has to issue debentures in order to pay its debts, must it not pay these debentures? Is not paying these debts part of the business of the company? * * * There being a good legal consideration, why should we not hold the debentures? * * * In the Master's office the defendants desired to shew that the full amount was not advanced. The company has never questioned these transactions, and the company is a party here."

In reply the appellants argued that,

> "The plaintiffs' position is not identical with that of the respondents. The plaintiffs have only claimed to hold debentures held by them as security for what is actually due them. The respondents claim the full amount due on the face of their bonds and interest upon them. The Act makes all the debentures a charge without preference or priority, but the effect of the directors' action is to give these respondents a preference and priority. The plaintiffs have advanced $80,000 and the defendants only $40,000, yet the Master has found larger sums due the defendants than the plaintiffs, thus giving the defendants a preference. The defendants cannot charge the lands of the company for any greater sum than they actually advanced in respect to the debentures actually held by them, and interest thereon. If the debts of the company had not been paid by the advances of the defendants, the creditors could only have recovered the amount due them. The claim of the defendants under the debentures is substituted for the claim of the creditors who have been paid by the advances, and cannot be enforced against the property of the company to any greater extent than could the claims of the creditors which have been paid."

In confirming the conclusions of the Master, the Chancellor said:

> "This action was brought by the plaintiffs in a representative capacity, and on behalf of all holders of

the debentures of the railway company. The respondents in this appeal were, therefore, substantially plaintiffs, as being holders of some of these securities, *and it is not competent for the plaintiffs on this record to attack their status*, and say that they cannot prove for anything. Though the argument was pressed thus far, it was nevertheless conceded that the bank was willing that the respondents should prove for so much of the money advanced by them as went into the road, or for its benefit; but it is disputed that they should prove for the face value of their debentures. The transaction between them and the managing director who was empowered to act for the company, is to be looked at. The bargain was, that they should take their securities in satisfaction and payment of their claims against the company. This involved a transfer of the debentures at some discount, but whatever this was, the transaction was not *ultra vires*, nor was it in any sense void. The company does not complain of it, nor does any shareholder. This being so, it is, in my opinion, *not competent for the holders of other debentures of the same class to impugn the respondents' position.*

"*The complaint is, that the directors abused their position so as to get an advantage at the expense of the company.* If this be so, it is for the corporation or its corporators to complain. To permit the bank to attack on this ground, would be to recognize the validity of the transfer of a right of action to complain of a fraud, actual or constructive. * * *

"This same view was upheld in *Greenstreet v. Paris*, 21 Gr., 229, which involved the consideration of dealings between a director and his company, and it was held that if the security which he took was capable of being confirmed by the shareholders and they did not nor did the company object, it was not for an outsider to complain."

As further authority that third persons have no standing to require the performance of a fiduciary obligation, we may refer to *Fisher v. McInerney*, 137 Calif., 28, where the real property of a judgment debtor was sold under execution.

Near the end of the period of redemption, the certificates of sale were purchased by his attorney for almost exactly the amount necessary to redeem and the attorney's nominee took the conveyance. He did not object. Held that even though the debtor were insolvent, his judgment creditors could not set the purchase of the certificates and the conveyance aside on the ground of the fiduciary relation between the judgment debtor and his attorney.

In Re Regent's Canal Ironworks Company, 3 Chancery Division, 43, is also an authority which we did not find in season to submit to the learned Trial Court; and the principle of which is directly in point. There, the Ironworks Company duly authorized the issuance of mortgage debentures for £25,000, to consist of 100 debentures of £250 each, and authorized their issue at 95. Sixty of the debentures were taken up by different persons and the remaining 40 were pledged to trustees as security for a loan made the Ironworks Company by the Financial Society.

The debentures were charged upon all the lands, property and effects which the Company held or possessed, or should hold or possess; and each debenture stated that it was part of an issue of 100 debentures of £250 each.

Upon the winding up of the Company, the Financial Society claimed the entire face amount of the debentures which it held in pledge, to which objection was made by the holders of the other 60 debentures, who claimed, *inter alia*, that, since the authorization of the debentures required them to be sold at 95, the Ironworks Company had no right, as against those who purchased their bonds at 95, to issue the others upon a different basis and, accordingly, objected to their participation upon an equality with those purchased at 95. The decree below having gone against the holders of the 60 debentures, an appeal was taken, which was heard by JAMES, L. J., MELLISH, L. J. and BAGGALLAY, J. A. JAMES, L. J., among other things, said:

> "The position of the Appellants is this: They are the owners of six-tenths of an aggregate mortgage of £25,000. They became the owners of that six-tenths of the debenture debt *with full notice that the company intended to deal with the other four-tenths as they might be*

advised. The company has accordingly dealt with the other four-tenths by making it a collateral security for the sum of £8,000 and interest at 10 per cent. That was the bargain between the *Financial Society* and the company. The company could not recede from that bargain, *and I cannot see that there is any equity on the part of the holders of the other six-tenths of the mortgage debt to alter the bargain between the debtors and the creditors.* * * *

" The Respondents have got this four-tenths of the mortgage debt quite as much as the Appellants have got the six-tenths, and the mode in which that four-tenths is to be applied is governed by the instrument which was executed between the company and the creditors."

Mellish, L. J., among other things, said :

" It appears to me that the proper way of looking at this case is to inquire what was the bargain with respect to these debentures as between the *Ironworks Company* and the *Financial Society*, and then to inquire whether the other debenture holders have any equity to prevent that bargain from being carried into effect. Now, as between the company and the society, there is no doubt that the debentures were to be a collateral security for the money which was lent upon the promissory note and the interest. That was the bargain between them, and one of the terms of the bargain was that the *Financial Society* was to be entitled to sell the debentures. Mr. *Glasse* argues, in the first instance, that because the resolution of the directors was that they should be issued at £95 and at 6 per cent. interest, they could not be issued on any other terms. But that was nothing more than a resolution of the directors, and they were perfectly competent to vary that resolution, *and to issue them in any other way.*

" Then the real question is : have the other debenture holders any equity to prevent that bargain from being carried out ? *The rights of the other debenture holders depend solely on their debentures, and they have*

nothing to do with the resolution of the directors as to the terms on which the debentures were to be issued. They can claim no greater rights than the debentures give them. The debenture says that the whole number is to be 100. The Appellants have got sixty, *and they are ult to have an equal security.* They took theirs by giving no doubt £95, and getting £100 security for each £95 that they advanced. Those were the terms, *and they left it open to the directors to issue the others on any other terms they might think advisable.* I do not see any reason why they should complain of the terms upon which the directors did issue them, namely, as a collateral security for the payment of the notes and interest. They are not injured, *as the debentures cannot be paid twice over—they can only be paid once.*"

Another case illustrating the principle is *Hodge's Appeal*, 84 Pennsylvania State, 359. There, Harmon executed to trustees a mortgage on certain of his property to secure 200 bonds of $500 each. Two bonds were sold and duly assigned to Hodge. The other 198 bonds were delivered by Harmon to Whitney as security for indebtedness. The amount of the indebtedness was not known except that it was in excess of $50,000, which was more than could be realized from a *pro rata* distribution of the proceeds of the sale of the mortgaged premises. The 198 bonds appeared not to have been properly endorsed, and Hodge contended that, inasmuch as he was a *bona fide* holder for value, he should be paid in full before Whitney could claim any part of the funds, because Whitney was not such a holder; that when Whitney obtained the bonds from Harmon, his entire indebtedness did not exist; that the record did not show what indebtedness there was at the time they were delivered; that they were not delivered as security for any money or credit obtained by Harmon at the time of their delivery; that they were not transferable by delivery but only by endorsement as stipulated in the bonds; that the right of the holder of bonds 1 and 2 is superior to any equities which may have been created between Harmon and Whitney by the delivery of the remaining 198 bonds, and also that the equities of the holder of said bonds are superior to the equities of Whitney. It appeared that, by their terms, the holder

of each of the bonds was entitled to the security of the mortgage.

The auditor found in favor of Hodge and awarded him the full face amount of his bonds. Whitney excepted, the court sustained the exception and directed that the fund should be distributed *pro rata* among all of the bondholders. From the decree entered on this decision, Hodge appealed. The Appellate Court affirmed the decree, saying:

> "The mortgage is a security for the whole number, and for each and every bond recited in it. By the terms of the instrument they stand in equal protection. *Each bond, therefore, carries only a fractional interest* of $500 in the property mortgaged. The fund arising from the sale of the property is its representative, and is owned by the bondholders in the same proportion. From the terms and nature of the mortgage, *the time and manner of the transfer of each are not material;* the only real question being whether each holder is entitled to it."

We think that the language of the court in the case last cited to the effect that each bond carries only a fraction of interest, to the extent of the face amount thereof, in the property mortgaged is not only absolutely sound, but is most apt as indicating the respective rights of the bondholders under the terms of the mortgage contract.

Neither of the three cases last cited were in our brief below. It did, however, contain other cases, absolutely analogous in principle, but which the learned Trial Court did not mention nor seek to distinguish in his opinion, no doubt because of the fact that he disposed of the issues upon the ground that the Power Company was insolvent and that the contracts were made with intent to defraud these Intervenors.

The first case is *Atwood v. Shenandoah V. R. Co.*, 85 Va., 966-978.

There the Railway Company had issued a mortgage, the terms of which limited the bonds to be issued thereunder to $15,000 per mile. Before all of the bonds had been issued under this mortgage it became apparent that the road could

not be completed through expenditures at that rate, and that certain extensions were desirable to place it upon a favorable operating basis. In order to obtain funds to continue the construction and to make the extensions a general mortgage was created authorizing an issue of bonds up to $25,000 per mile, the lien of which mortgage was to be subordinate to that of the first. In order to strengthen the security of the second mortgage bonds, the Company caused to be certified $1,560,000 of bonds which, at the rate of $15,000 per mile, it *would be* entitled to have certified upon the completion of the road; and pledged the same under the second mortgage. Prior to the creation of the second mortgage $2,270,000 of bonds had been issued under the first. Accordingly, the $1,560,000 of additional first mortgage bonds issued and pledged under the second mortgage constituted a very large proportion of the aggregate of the bonds claimed to be secured under the first mortgage. At the time that the action was brought, the Railroad had been completed in accordance with the requirements of the first mortgage, so that, when the questions presented were considered, *the security behind the same was precisely that which was originally contemplated by the contract made between the mortgagor and those who had purchased the $2,270,000 of bonds*, and who had intervened in the proceedings and raised the questions which were considered.

Whether or not the first or general mortgage, or both, were under foreclosure, does not clearly appear from the report, especially as the trustee under each mortgage was the same. As stated, however, it is clear that appellants presenting the issues material to the case at bar were first mortgaged bondholders who had intervened in the foreclosure suit after it was begun (pp. 969, 970). When they were admitted, one Clarke was also permitted to intervene in his own behalf as a holder of general (second) mortgage bonds and in behalf of all the other holders of such bonds. The individual first mortgage bondholders answered Clarke's petition in intervention and alleged that the deposit of 1560 of the first mortgage bonds as security for the general mortgage was unauthorized and illegal; that the trustee had taken a position antagonistic to the interests of the first mortgage bondholders and that the question as to the validity of the 1,560 bonds was one of the

issues in the pleadings with respect to which testimony had been taken before the Master, who had already held such bonds to be invalid. It appears also that the Master had theretofore taken testimony upon all of the issues and upon the rights of all of the parties and had prepared and submitted to counsel a draft report which, among other things, found against the validity of the 1,560 bonds. After the general mortgage bondholders intervened, additional testimony was taken, but, apparently, the Master did not change his report, although he filed therewith all of the testimony taken before him (pp. 971–972). The order sending the matter to the Master required him to ascertain "the rights of the respective classes of creditors * * * to satisfaction out of its (the mortgagor's) property and assets, and the amount due or to become due to said classes respectively."

He was also directed to take an account "of the amounts due or hereafter to become due under the respective deeds or mortgages which" had been made by the Railway Company showing "the relative rights and priorities and the property included or conveyed by said deeds respectively" (p. 969).

In behalf of the general mortgage bondholders, Clarke excepted to the report of the Master upon the ground that he had held invalid the 1560 first mortgage bonds deposited as security under the general mortgage; and it was upon such exception that the court heard and determined the question, from which determination the individual first mortgage bondholders appealed. The analogy of the situation of the bondholders there considered to that of the intervenors here is, therefore, extremely close. In disposing of the matter, among other things, the Court said:

> "It is not perceived that the Railway Company, in thus pledging these 1560 first mortgage bonds, as security for the benefit of the general mortgage bondholders, *did any injustice to or violated any contract rights of the first mortgage bondholders.* * * * The road has been extended and completed and bonds at the rate of $15,000 per mile, and no more, have been issued under and in pursuance of the terms of the first mortgage, the $2,270,000 of bonds held by the first mortgage bondholders, and the $1,560,000 of extension

bonds issued thereunder and pledged for security of the general bondholders, together, make the aggregate of $3,830,000 at $15,000 per mile of the line of road actually constructed.

"The proceeds of the bonds held by the first mortgage bondholders were expended entirely upon the construction of the part of the road north of Waynesborough, not a dollar thereof having been expended south of that point, while the extension south of Waynesborough was built exclusively with funds derived under the general mortgage. *Yet, the first mortgage bondholders claim a lien over the entire line of road prior and superior to those of the general mortgage bondholders. The claim is preposterous.*

"It is true that the general mortgage was made expressly subject to the first mortgage, but, be it observed, *it is subject not to the rights of the present first mortgage bondholders merely, but to all the rights secured by the first mortgage, prominent among which is the right to issue and use the additional bonds here in controversy.* * * * Though these 1560 first mortgage bonds issued and deposited as collateral for the general mortgage bonds be held to be valid securities under the general mortgage, and they certainly are such, *how does that fact impair in any way the contract rights of the first mortgage bondholders?* * * * Suppose the Railway Company had issued those bonds and put them on the market for the purpose of securing funds with which to aid the construction of the extension of its road, and it undoubtedly had the right to do so, in what worse position would the first bondholders be placed than they are by the application of them as strengthening plaster —as a first lien backing support to the general mortgage bonds? It is certain they would be in the same relative position now held by them, *and that is the position of their own choosing.*"

Does not the language of the Virginia court apply almost precisely to the situation of these intervenors? As the road there had been completed and was subject to the lien of the first mortgage bondholders at the rate of $15,000

per mile, so here the additional properties have been purchased and the additional improvements and betterments made, all as stipulated in the contract. As stated in the opinion, therefore, how could the issue of the additional bonds do "any injustice to or violate any contract rights of" the first mortgage bondholders whose securities had been issued prior to such acquisitions?

While there the first mortgage bondholders claimed a lien over the entire line of road to the cost of constructing the extensions of which they contributed nothing, prior and superior to the lien of the second mortgage bondholders, as represented by the remaining 1,560 first mortgage bonds, here the holders of the bonds first issued claim a lien upon the entire property of the Power Company, including the ~~acquisitions of~~ additional properties and the betterments and improvements to the cost of which they contributed nothing and for which the 718 bonds were issued. In the language of the opinion, "the claim is preposterous."

The controversy there was between the first and second mortgage bondholders. Had these 718 bonds been delivered to the trustee under the Power Company's second mortgage, the situation of the two cases would be absolutely identical. Suppose that this had been done and the issue here was as to the price, terms or conditions under which the second mortgage bonds had been issued or as to the right, after foreclosure, of the holders of the second mortgage bonds to participate in the proceeds of the first mortgage security, can it be reasonably contended that these intervenors would have had any standing for such a contest? And if not, why? Is not the only answer that they have all the stipulations of their bond and that they are not entitled to more? Since the company might have utilized the bonds as security for its second mortgage bonds, why might it not legally and properly exchange its first for its second mortgage bonds? So far as its obligations were concerned, they were precisely the same with respect to both classes of bonds; that is, it was equally bound to pay the seconds as the firsts. From its standpoint, therefore, when, by making such exchange, it reduced its interest charges to the extent of more than $7,000 per year, not to mention the $250,000 received at the same time by way of loan, how can it be said that the interests of the company were made to

suffer any more than though the 718 bonds had then been deposited as security for the second mortgage bonds, which deposit, under existing conditions, would, except as to the 166 second mortgage bonds held by others than the Railway Company, have brought about precisely the situation which now exists; that is to say, the *pro rata* interests of the 718 bonds in the proceeds of the sale would have been required to be paid to the trustee under the second mortgage and all of such proceeds, except the proportionate share of the 166 bonds, would have come to the Railway Company.

Another of the statements of the Virginia Court of Appeals which we have emphasized by our italics is equally applicable here, namely, that though the general mortgage there was expressly subject to the first mortgage, "be it observed, *it is subject not to the rights of the present first mortgage bondholders but to all the rights secured by the first mortgage, prominent among which is the right to issue and use the additional bonds here in controversy.*" Again, using the words of the Virginia court, assuming the validity of the 718 bonds and their security under the first mortgage, "how does that fact impair in any way the *contract rights* of the first mortgage bondholders?"

Suppose further that, as the Railway Company had the right to do, it had issued those bonds and put them on the market, it could have sold them for whatever price they might have brought, be it much or little; in which event "in what worse position would the first bondholders be placed than they are by the application of them" to the procuring of funds and the release of large liabilities. Thus, the Power Company obtained for these bonds $250,000 in cash, with a year's time within which to recuperate and, if necessary, remodel its business, during which time it would save more than $7,000 in interest charges; these funds enabled it to continue its business as a going concern and enabled it to continue to indulge the opportunity of establishing itself upon a profitable basis; the subsequent contract, under which 218 bonds were received, enabled it to be rid of a cash claim of more than $85,000, to terminate a construction contract which, as then anticipated, if completed, would have cost it $100,000 more than if the work done under its revised plans; it was to enable it to utilize $25,000 of

its second mortgage bonds in lieu of $20,000 of cash, because of the Railway Company's guarantee or agreement to purchase ; and it obtained the benefit of 50 shares of the Railway Company's preferred and 100 shares of its common stock which, whatever now may be the case, was then, undoubtedly and justifiably, considered to possess value.

Had the 718 bonds been forced upon the market with the statement that the Company's earnings during 1912 were showing a deficit of more than $50,000 ; that these results were obtained at a time when its rates to its customers were satisfactory ; that a powerful competitor was coming into the field who was then soliciting, and in December had obtained contracts from the Power Company's customers on the basis of reduction in service charges of approximately 40 per cent., that, in order to retain any part of its business the Power Company would be compelled to meet these reductions, and, possibly, to go below them which would, necessarily, precipitate a rate war, as the result of which both companies would likely conduct their business at a loss until one or the other should be financially exhausted; if these statements had been made to the public in connection with an offering of the bonds, and it would have been dishonest and dishonorable in the last degree had the bonds been offered to the public without such a statement, would this Court say that the bonds could have been sold on a basis which would have realized for the Power Company the net results which it obtained from the two contracts in question ? In the language of the Virginia Court of Appeals, we say again " the claim is preposterous."

In order to reach this conclusion, it is unnecessary that the Court shall be an expert in the sale of corporate securities Judges are not debarred from exercising the judgment which is credited to the average business man ; and, considering our suggestion in that light, we cannot believe that any unprejudiced court will be able to conclude that the bonds could have been sold at any price. Most respectfully, therefore, we submit that the suggestion contained in the opinion of the learned trial court to the effect that those 5 per cent. first mortgage bonds might then have been sold at a reasonable discount, for which reason, the failure of the Railway Company interests to follow that course must necessarily be held to convict them of

an intent to defraud these intervenors or any other man, woman or child in the universe, was wrong, dreadfully and most seriously wrong; and that the plainest dictates of justice and of the considerations which should affect men in their dealings with each other, require that the printed record of this charge of fraud and unfair dealing which has now been distributed broadcast, shall, to the extent that this Court is able so to do, be expunged from the tablets of time; and that this Court shall give the same publicity to the arguments and conclusions, which we fervently hope and seriously believe it will advance and reach, repudiating these grievous accusations and removing from the records of honorable men the imputation and stain which has been placed upon them by the learned trial judge. We trust that the Court will pardon us if, at times, the language of this brief is somewhat vehement. In extenuation, we beg to say that, although, as previously stated, he had no association with the transactions here questioned, some of the men here accused are the writer's friends, whose thoughts, general intentions and every day attitude toward the world, he knows from personal contact; whose consideration for the very bondholders, some of whom are now represented by the intervenors, after coming into this matter, he had an opportunity to observe; and whose regret that such bondholders were sufficiently misguided by these intervenors to be influenced greatly against what they believe to be their best interests, he has been enabled to consider and understand.

Weed v. Gainesville R. Co., 119 Ga., 576, is another case, the underlying principle of which is directly in point. The report of the case is long and somewhat involved. A careful consideration thereof, however, discloses the following: It was a consolidation of two foreclosure suits. The holders of $83,500 of a total issue of $245,000 of first mortgage bonds *intervened individually* and set up that the disposition of the majority of the stock of the mortgagor *and of the remaining $161,500 of bonds authorized under the first mortgage* were *ultra vires* and invalid; and that the present owners of the $161,500 of bonds "were not entitled to share equally in the proceeds of the sale of the mortgaged property" (pp. 581 to 585, 589 and 590). The Auditor found against the individual intervenors, who appealed from the order overruling

their exceptions; and it was upon such appeal that the court considered the right of the individual first mortgage bondholders to raise the question as to the interest of the other first mortgage bondholders in the security under that indenture. The argument was, as before shown, that the $161,500 of bonds were *disposed of* illegally; and the Court will observe that the complaining bondholders there represented one-third of the total issue and were seeking to exclude from participation two-thirds of that issue, and that, accordingly, the situation of the contending bondholders there was, so far as percentages on return are concerned, greatly more serious than is the situation of the intervenors here. The point was also made there that the $161,500 of bonds had been issued to a competing company which, under a Georgia statute, also rendered such issue illegal. The opinion was by Mr. Justice Lamar, now a member of the Supreme Court of the United States. Among other things he said (p. 590): "Bondholders are not authorized to act as guardians for the public or the parties, in having such a contract set aside or declared to have been illegal * * *."

The decree of the court entered upon the findings of the master, to which exception had been taken by the holders of $83,500 of bonds, was affirmed.

In *Keystone Nat. Bank v. Palos Coal Co.*, 43 So., 570, the bill was filed by a bondholder for the benefit of himself and all other bondholders, as well as for general creditors, and prayed "the annulment" of certain bonds issued under the same mortgages under which those held by plaintiff were issued, on the ground that they had been *illegally disposed of* by the company. The language of the court is peculiarly apt in its application to our case. Thus (p. 571):

> "While the bill prays specifically for the 'annulment' of certain bonds held by the respondents, the relief sought in this respect is inappropriate to the facts stated in the bill. The bond issue was for corporate purposes and benefits, and was made under corporate authority, and it is not pretended, in so far as is shown by the facts stated in the bill, *that there was any illegality in the issue of the bonds.* The facts stated tend to show, *not an illegal issue, but rather an illegal disposi-*

> *tion of the bonds after the same had been legally issued.* If the bonds were 'hypothecated' without consideration, and in this manner parted with and disposed of, this would be a corporate wrong. The remedy in such a case, it would seem, would not be the 'annulment' of the bonds, but a restoration of the bonds to the rightful custodian, *and the relief should be sought and had in the name of the corporation.*"

The bill was dismissed.

Further discussing the situation there shown, the court said (p. 571):

> "It is not shown whether the general creditors are subsequent or prior creditors to the issue of the bonds. A general creditor, as well as a bond creditor, may attack the illegality of issue of bonds secured by mortgage on corporate property (3 Cook on Corporations, 5th edition, Secs. 766*a*, 848); and having a common grievance to be remedied, and with like relief, namely, the 'annulment' of the *illegal issue*, no reason appears why the two classes of creditors, to that end and in a proper case may not join in the same bill."

The bondholder may attack the *illegal issue* of bonds secured by the same lien as his own, if for no other reason, because it violates his contract. As the court pointed out, however, when the bonds have been legally issued, that is (in our case) when the additional property, improvements and betterments have been obtained or made, due evidence thereof represented to the trustee and the bonds certified by it and delivered to the mortgagor, they are legally issued. Accordingly, if, as in the case last discussed, they have been hypothecated *without consideration* (which is tantamount to the situation resulting from a gift of the bonds), the question becomes one of their proper disposition, which question is beyond and outside of the terms of the contract between the bondholders and the mortgagor and one solely between the corporation or its stockholders, the legal or equitable owners of its property, and those who participated in the alleged illegal transaction (disposition).

Of course, in considering the transactions as exchanges of

first for second mortgage bonds, the question is one purely of a legal consideration and, therefore, cannot in any view of the case affect the rights of the intervenors. That such questions are within the powers of a corporation and its officers to determine, was decided in *Claflin v. S. C. R. Co.*, 8 Fed., 118, 131, where the opinion was written by Chief Justice WAITE of the Supreme Court of the United States. There, the corporation had utilized bonds secured by the mortgage in question to pay wholly unsecured obligations, just as in the case at bar, the exchange of the first mortgage for the second mortgage bonds, discharged the obligation under the latter. The court said:

> "There was no actual exchange of bonds, but the new bonds were put in a way of being applied for the old ones. All this, as it seems to me, is *within the scope of the mortgage. It may not have been judicious management but it was within the discretion of the company. The only contract with the individual bondholders is that the mortgage security shall not be diverted from its designated uses.*"

And that there is nothing *per se* illegal in exchanging an inferior for a superior security is also held in the following cases:

Re Snyder, 59 N. Y. Supp., 993.
People v. Stevens, 90 N. E., 60.

In *Farmers Loan & Trust Co. v. Toledo*, 54 Fed., 759, it appeared that a bank seeking to participate in the proceeds of a sale of properties covered by a mortgage and purporting to secure bonds which it held, was met with the objection on the part of the other bondholders—that the bonds had been originally pledged to the bank and—that, at a sale to foreclose its pledge, the bank had itself illegally become the purchaser, for which reason, it could not be held to be the owner of the bonds and entitled to prove for their full amount. In deciding the matter, among other things, Judge JACKSON, speaking for the court, said:

> "The sale and purchase of these bonds by the bank * * * was not, *per se*, void. It was at most only

voidable at the instance and upon reasonable objection *upon the part of the corporation or its stockholders.*

Third parties or strangers have no right to question or challenge the bank's title to the bonds on the ground either *of inadequacy of the price paid for the same, or for the reason that it occupied such a quasi trust relation to the pledgor as to disqualify it from purchasing at a sale made for its own benefit.*"

As the Court will have observed from the authorities cited, all except *Keystone Nat. Bank v. Palos Coal Co.*, 43 So., 570, *supra*, arose under conditions similar to those which, for the purpose of the argument, we have assumed will exist here, namely that the security had been sold and other bondholders of the same issue were objecting to the equal participation of the holders of the bonds of whose disposal they were complaining. Yet, upon the argument below, the only response made to the propositions which we are here advancing, was that, whereas, as general propositions they may be correct, they have no application after a foreclosure and sale, as the result of which it has been determined that the security will prove insufficient to pay all of the bonds in full and, therefore, has demonstrated that those situated as are the intervenors will suffer. Although, heretofore, we have somewhat considered the results to which such an argument leads, it now occurs to us to add that whereas, of course, the intervenors could not complain if their claims were paid in full, that circumstance bears no essential relation to the question as to whether or not they have rights outside of their contracts, which, in our view, is the fundamental portion of the question which we are now considering. Indeed, unless the transaction were void *per se*, or was made with express intent to defraud them, the discussion already had discloses that the intervenors are not in a position to question its results. Such being the case, the principle involved cannot be affected by the circumstance that the issues are made subsequent or prior to insolvency, especially if, as in the Keystone Bank case, the bill alleges that the companies assets are insufficient to pay its debts, which fact was admitted by the demurrer to the bill.

In order to sustain the proposition that the question is

affected in any degree by the matter of the ability or inability of the mortgagor to pay all of the bonds, must we not go to the point of concluding that, regardless of the provisions of the contract under which the intervenors took their bonds and of the performance thereof by the mortgagor, they may assert rights which, primarily, concern only the corporation and its stockholders, provided it be shown that their security is insufficient, which is the very point decided adversely to such contention in the Keystone case. And if that proposition be conceded, must it not necessarily result in making a new contract between the parties, namely, in adding a provision to the mortgage that, despite the covenants to the effect that additional bonds may be issued when the required additional security has been placed under the lien of the mortgage, such covenant does not apply if and when the corporation becomes insolvent. If any such principle be established, where will it end? Will it not render uncertain the rights and interests of mortgage bondholders to such an extent that no one will feel justified in purchasing such securities in reliance upon the provisions of a mortgage.

In considering the intervenors proceeding one to exclude the 718 bonds from any share in the distribution of the proceeds of the foreclosure sale, must we not, in order to sustain their contentions, also assume both that, had the bonds not been exchanged for the second mortgage bonds, they would have been in the treasury when the Receiver was appointed, and that, so situated, they would not have been entitled to participate in the distribution of such proceeds. So far as the first of these suggestions is concerned, it will be recalled that the Receiver of the Power Company was not appointed until December, 1913, fifteen months and one year following the respective transactions. In view of the fact that, in face of the competition which became effective in January, 1913, the company was sustained as a going concern, during the time mentioned, despite its inability to pay the interest on its first mortgage bonds on April 1, 1913, little room is left for the assumption that the 718 bonds would have been in the Power Company's possession when the Receiver was appointed, because, until the officers and directors of the company finally determined that it was useless to further prolong its struggle against adverse conditions, it would have been their duty to utilize its resources for the purpose of maintain-

ing it, which, indeed, is all that was done; and had the bonds been sold, is there any evidence before the court that the proceeds of such sale would or could have been presumed so as to have provided adequate security for the intervenors' and for the 718 bonds, or even that the improvement of the security, evidenced by the additions and betterments, as shown by the company's balance sheet, during the last three months of 1912, would have been realized? Indeed, is it not wholly probable that such proceeds would have been utilized in paying interest on all outstanding bonds and, as were the resources subsequently obtained, largely, if not wholly, consumed in waging the battle of competition which began in January, 1913. Whatever else may be said on this subject, however, surely in considering it, we enter the realm of speculation and cease to deal with facts.

The fact that the intervenors' contention also necessarily leads to the assumption that, had the bonds been in the Power Company's possession when the Receiver was appointed, they would not be entitled to be admitted to distribution, presents a much more serious question and one which under such circumstances as those existing here, it appears to us would be resolved against the intervenors.

Thus, the record shows that, during the years 1908 and 1912, inclusive, "the Power Company had no other source of income or revenue from which expenditures could be made in underlying bonds, purchasing properties or making additions, enlargements, etc., to its plants and properties, *than the proceeds of earnings and of second mortgage bonds*, where the expenditures were not originally made in the first instance from the proceeds of the first mortgage bonds" (p. 432). Such was the testimony of Mr. Markhus, who was the company's general manager during the entire period mentioned. So far as the exception mentioned in his statement is concerned, it is of little consequence in considering the additions to the security of the bondholders which are represented by the 718 bonds, because all bonds previously issued were for purposes specifically prescribed by the mortgage. It follows, therefore, that all of the property, plants, additions, betterments and improvements, represented, so far as retirement of liens upon underlying properties and the acquisition of

new properties are concerned, and, to the extent of 90 per cent. thereof, so far as expenditures for betterments and improvements are concerned, were acquired and made through the use of the company's earnings or from the proceeds of its second mortgage bonds. In other words, neither the intervenors nor any other first mortgage bondholder, except the Railway Company ~~and its assignors, and the company's stockholders~~, contributed one dollar of the more than $800,000 represented by the 718 bonds. Under such circumstances, does it offend the conscience of a court of equity to suggest that those whose moreys have thus enhanced the value of the mortgage security, shall be protected in the distribution of the proceeds thereof ? And how may they be protected, unless, if the bonds, duly issued and certified, are held by the mortgagor at the time of its insolvency, the mortgagor receives the distributive portion of such bonds for the benefit of the second mortgage bondholders, general creditors or stockholders, as their interests may appear. Unless this question receives an affirmative answer, can equity be done in such a situation ?

Can these intervenors make any other answer to such proposition except to say that "it is true that your moneys have been expended to the extent of more than $800,000, which expenditures redound directly to the enhancement of our security, but you are entitled to no consideration for such expenditures, because neither our contracts with the mortgagor nor your contracts with the mortgagor provide that, if bonds issued against expenditures made by the second mortgage bondholders and others are not sold by the company, regardless of the price realized, you shall have no benefit from such expenditures but all of them must be held solely for our benefit ? "

Does it lie in the mouth of those who say, that regardless of the provisions of their contract, they are appealing in the broadest scope to a court of equity, to take such a position ~~as that~~ ?

As we have before mentioned, provisions in mortgages of the character of those here under discussion are quite modern and questions such as that which we are now considering have not, therefore, apparently been presented for judicial determination. We are frank to say, therefore, that, although we

consider the contention absolutely sound as a matter of principal, we have been able to find only one reported case which appears to sustain it. We have, however, found no case to the contrary.

A case apparently in point is the *Trust Company of America v. United Boxboard Company*, decided by the Appellate Division, First Department of the New York Supreme Court, in June, 1914, and ~~being~~ reported in 162 App. Div., 855.

There, pursuant to the provisions of a mortgage made by the predecessor of the defendant company, bonds, secured by such mortgage, were to be issued upon the delivery to the trustee thereunder of stock of the American Straw Board Company, in the proportion of $1,000 of bonds for each $3,300 par value of stock so deposited. "The mortgage provided that for all purposes, including the right to deposit stock and receive bonds therefor, the mortgagor's rights should appertain to its successors and assigns." Within a short time following the issuance of the mortgage, the trustee certified and issued bonds to the extent of $1,302,400. In 1908, two years following the making of the mortgage, Receivers of the mortgagor company were appointed who sold all of its assets to a reorganization committee, in consideration of the assumption and payment of all of the obligations of the mortgagor company, except its obligation upon the bonds secured by the mortgage. It was expressly provided in the order authorizing such sale that the committee or its nominee "should have the same right to the certification, delivery and use of the bonds to be issued under such collateral trust mortgage as the United Box Board and Paper Company (the mortgagor) had theretofore had, but upon the terms and conditions of said mortgage." The reorganization committee organized the defendant company and designated it as its nominee to whom the assets of the mortgagor company should be transferred, and they were accordingly so transferred. Among the assets thus received by the defendant were $330,000 par value of the stock of the American Straw Board Company, which it deposited with the trustee under the mortgage in question and for which it received in exchange, bonds duly certified to the amount of $100,000. In 1911, the action was brought to foreclose the mortgage, which then covered 46,280 shares of

American Straw Board Company stock, of which 42,980 had been deposited "by the original mortgagor company and 3,300 by this defendant." The stock was sold upon foreclosure for $250,000. The court below had found, as a matter of fact, that all of the bonds certified by the trustee were outstanding in the hands of holders for value, except $16,000 thereof, which remained in the treasury of the defendant. The court said (p. 857):

> "The present controversy is over the right of defendant to participate *pro rata* in the balance of the purchase price on account of the $16,000 of bonds held by it. * * * It is stated, and without verifying the computation we assume it to be a fact, that the precise sums ordered to be allowed to the purchasers for the bonds held by them were calculated upon the assumption that this $16,000 of bonds were not entitled to participate in the proceeds of the sale. *If this be so it is due undoubtedly to a mistake as to the status of those bonds.*"

After discussing whether or not the application rendered necessary the amendment or alteration of the judgment which determined the number of bonds entitled to share in distribution, which excluded the $16,000 thereof under consideration, and determining that, so far as moneys remained undistributed, it had the right, if they were entitled, to admit the $16,000 of bonds to participation in such distribution, the court further said:

> "So far as concerns the $16,000 of bonds in question, we can see no reason why they are not entitled to participate in the distribution. They were duly certified and issued by the trustee against stock deposited in strict conformity with the mortgage, and the stock against which *they were issued was a part of the stock which was sold in foreclosure and thereby contributed pro tanto to the creation of the fund to be distributed. They became valid obligations under the mortgage when they were certified and issued by the trustee,* and their validity is in nowise affected by the circumstance that defend-

ant, after it had lawfully acquired them, kept them in its own treasury, instead of selling them to some one else."

Applying the language of the opinion to the case at bar, *mutatis mutandis*, the 718 bonds were duly certified and issued by the trustee against the discharge of underlying obligations, the acquisition of additional plants and property and against 90 per cent. of sums expended by the mortgagor for betterments and improvements, all in strict conformity with the mortgage; and the properties thus discharged of lien, thus acquired and thus added to the security of the mortgage lien, and against which they were issued, are a part of the property which will be sold in foreclosure and will thereby contribute *pro tanto* to the creation of the fund to be distributed. Within the terms of the decision, did they not, therefore, become valid obligations under the mortgage when they were certified and issued by the trustee, and would their validity in any wise be affected by the circumstance that, after it had lawfully acquired them, the company had kept them in its own treasury instead of selling them to someone else?

It will be observed that, in the case last mentioned, the court appeared to consider that the defendant company there had been substituted in all respects for the mortgagor company, and seems to dispose of the question upon principle rather than upon consideration of the circumstance that the defendant company had succeeded to all of the rights and interests of the mortgagor company, including the right to the certification, delivery and use of bonds issued under the mortgage, which the mortgagor company theretofore had; and that view of the matter appears to sustain absolutely the proposition for which we are now contending.

The order of the Appellate Division was, under date of January 5, 1915, reversed by the New York Court of Appeals, the case not yet being reported. We have procured a copy of the opinion, however, and find that the reversal proceeds upon the legal proposition that, since the judgment of foreclosure determined the number of the bonds outstanding under the mortgage, which number excluded "bonds in treasury $16,000," so long as the judgment stood unreversed or unamended, the Appellate Division was without power to

admit the $16,000 of bonds to distribution, which conclusion would appear to be correct. The Court of Appeals does not, however, contest the correctness of the Appellate Division's conclusions with respect to the legal right of the $16,000 of bonds to participate and, indeed, at an early part of the opinion, says :

> "To determine its force and effect, it is necessary to ascertain precisely what, if anything, was adjudicated by the judgment proper in the action with respect to the said $16,000 of bonds. We shall assume now that the record disclosed, as a matter of fact, *that these bonds were entitled to share in the proceeds of the sale.*"

In order that this Court may be fully advised in the premises, we are taking the liberty of handing up to each of the Judges a copy of the opinion of the New York Court of Appeals.

We have given the report of the case very fully, in order that the Court itself may determine if it is in point upon the question under discussion. We recognize the possibility of distinction because of the fact that the defendant was not the mortgagor Company and may, therefore, have been considered to substantially be in the position of one purchasing the bonds for the deposited stock. The case as reported, however, gives no suggestion that the Court was affected by any such consideration. On the contrary, the entire presentation of facts and discussion suggest strongly to us that the Court considered and intended to dispose of the issue with respect to the right of the $16,000 of bonds to participate as though the defendant were the mortgagor Company.

We submit most earnestly, therefore, that upon principle, supported by an abundance of authority, the Intervenors are shown to have no interest whatsoever in seeking to avoid the transactions between the Power Company and the Railway Company ; and, upon principle, and what appears to be authority, that the 718 bonds, if in possession of the Power Company's Receiver, would have been admitted to participation upon distribution, in which event, of course, all of the contentions of the Intervenors fail, because, were

the transaction rescinded *in toto*, their positions would not be changed. We would add, however, a word more to the discussion : Since, obviously, none of the 718 bonds are a part of the $500,000 authorized to be delivered by the Trustee at the time of the completion of the mortgage, nor a part of the $2,000,000 thereof authorized to be used in connection with the Company's Ox Bow development, as the General Manager testified, the property against which they were issued could not have been acquired by the mortgagor with the proceeds of the First Mortgage Bonds held by the intervenors and others, the aggregate of which is, as the record shows, $2,944,000. In addition to that self-evident proposition, the testimony of the General Manager shows that, as a matter of fact, part of the moneys utilized to retire the underlying bonds, to acquire the additional plants and properties and to make the improvements, additions and betterments, represented by the 718 bonds, came from the Company's earnings and part from the proceeds of the sale of the Second Mortgage Bonds. Such being the situation, where do the abstract equities lie ? If, as we contend is the case upon principle and, apparently, upon authority, the bonds became the Power Company's absolute property when they were certified and delivered to it, abstract equity would require that they be utilized to restore to the Second Mortgage bondholders and to the stockholders that which they have contributed to the enhancement of the security. Although we have found no authority applying the principle of subrogation to such a situation, why should it not be so applied by a court of equity ? Under conditions which render possible such a situation, a just provision to insert in first mortgages and in second mortgages would be that all first mortgage bonds issued against property acquired through the use of funds obtained from second mortgage bonds, should be deposited as additional security under the second mortgage ; and, if that result be just and equitable, with the 718 bonds still in the possession of the Power Company, why should not such result be accomplished by permitting the bonds to participate upon distribution for the benefit of the second mortgage bondholders, in which event, as before observed, with the exception of the 166 bonds now in the hands of the public and $30,000 thereof held by the Bates & Rogers Construction

Company (p. 260), such distributive share will be paid to the Railway Company.

We do not enlarge upon this phase of the question, because it deals only with a supposed condition and, in our view, is unnecessary for the purpose of determining the issues adversely to the intervenors. It is submitted, however, that modern authorities go to the point of establishing that the right of subrogation is not dependent upon a relationship of principal and surety, or of any other situation whereby, under some contract provisions, one is liable for the obligation of another, but extends to any situation where, in the view of a court of equity, the property of one has been or will be taken to pay the obligation of another under circumstances which will result inequitably to him whose property is or will be so taken shall be permitted to succeed to or participate in the rights of those who have been benefited thereby.

Thus, in Pease v. Eagan, 131 N. Y., 262, the general principle involved is stated as follows :

> " No contract is necessary upon which to base a right of subrogation ; it is founded upon genreal equitable principles, and may be asserted by one who has no absolute interest in property, but who, upon the happening of a contingency, may become the owner, and who in order to save the property, pays the debt which is a lien thereon."

Although here, the debt was not paid, the money of the Second Mortgage bondholders was used to build up the security of the First Mortgage bondholders, under the terms of a contract between the mortgagor and the First Mortgage bondholders, known to the Second Mortgage bondholders, pursuant to which, the Company could reimburse itself for such expenditures and, therefore, protect the Second Mortgage bondholders, either by taking out bonds under the mortgage and, as we contend, holding them in its possession, or, as is obvious from the authorities cited, by depositing them as additional security under the Second Mortgage. As, in substance, the latter is what has here taken place, not only, in their last

analyses, do the transactions not offend the principles of equity, but they merely accomplish for the Second Mortgage bondholders what, had the exchanges of bonds not been made, equity should have accomplished for them.

VI.

Upon the theory of rescission, which the court adopted, it was error to confine the right of the Railway Company as pledgee to 440 first mortgage bonds; and to limit to $110,000, the obligations for which they can be held (Supplementary decision, pp. 153, 154).

Taking up first the number of bonds subjected to the Railway Company's lien, we assume that the theory of the lower court in charging them only upon the 440 bonds was that Mr. Hendee testified that such number were deposited by the Power Company as security for the $250,000 of notes. If, however, the transactions between the Power Company and the Railway Company are not sustained *in toto*, it will be because the court will ignore the actual terms of the agreements and hold, not that they mean what they say, but that they were mere subterfuges whereby, so far as the September arrangement was concerned, in consideration of the advance by the Railway Company of $250,000, or of $110,000, the Railway Company obtained what purported to be title to $500,000 of bonds; and, in connection with the December arrangement, obtained what purported to be title to $218,000 of bonds. In other words, the court will disregard the agreements made by the parties and hold that the transactions thereunder will be upheld only in so far as may be necessary for the protection of the Railway Company to the extent of the moneys, or other consideration, actually advanced. It is grossly inequitable, therefore, for the Court to confine the Railway Company to the terms of the contract, so

far as the parties made a record of the bonds actually delivered in pledge, but to repudiate the contract for all other purposes, and, thereupon, afford the Railway Company relief, only upon the theory that, since the Intervenors seek equity, they must do equity.

The evidence shows that, so far as the exchanges of bonds are concerned, no discrimination was made in utilizing the first mortgage bonds originally deposited as security for the notes. It would seem only proper, therefore, to consider that, since the parties undoubtedly intended to carry out the contracts in accordance with their terms, when the acts were performed by which the actual exchanges were accomplished, they did what would be usual under such circumstances, and, accordingly, that they intended to first complete the exchanges under the first contract and then to complete the exchanges under the second contract. We can, therefore, find no justification whatsoever in the evidence for any discrimination between the bonds acquired under the two contracts, except that evidenced by their terms, the earlier of which limited the exchanges thereunder to $500,000 of bonds (See Contracts ; also Record, page 259.)

Passing now to the justification for limiting the rights of the Railway Company to the recovery of $110,000, without prolonging the discussion by referring *in extenso* to the views of the learned Trial Court, it is obvious that it was influenced to that result by concluding that Messrs. Kissel, Kinnicutt & Company, the Syndicate and the Railway Company are but different terms for the same legal entity, and that, accordingly, the Railway Company was obligated to purchase the remaining Second Mortgage Bonds under the contract of September 19, 1911, between the Power Company the Messrs. Mainland and Kissel, Kinnicutt & Company. What may be the justification for this conclusion on the Court's part, we are unable to understand. The only evidence on the subject contained in the record will be found at pages 195 to 197. Summarized, it is that, *after* the contract of September 19, 1911, was made, " a syndicate was formed *to take over the holdings* of Kissel, Kinnicutt & Company in the Power Company, *and in other properties which they had acquired and which later became the properties of the Railway Company.*" Thereupon, the general nature of the Syndicate's holdings and

the manner in which the stock relationship between the Railway Company and the Power Company was established are stated, and further explanation with respect to the Syndicate is made as follows: It was composed of from 50 to 100 individuals who resided in various parts of the country, each member of which had a stated participation. It was not a bond syndicate, but a "construction syndicate." Messrs. Kissel, Kinnicutt & Company were the Syndicate Managers and, although that firm did not have the largest financial interest, it was, otherwise, the principal interest. Such is the entire record on the subject. Does it necessarily lead to, or does it even justify, the conclusion that the obligations of Messrs. Kissel, Kinnicutt & Company under the contract of September, 1911, were in any sense turned over to the Syndicate, much less to the Railway Company?

The record discloses also that the Railway Company began business about January, 1912, more than three months after the contract of September, 1911, was made. There is no evidence whatsoever that the contract was turned over to the Syndicate or that it was turned over to the Railway Company, the only other material evidence on the subject being that the securities taken by the Bankers under their contract were eventually turned over by them to the Railway Company. In the absence of affirmative and positive evidence to that effect, can it be justifiably held that such circumstance alone imposed upon the Railway Company all of the obligations assumed by the Bankers under the contract? If so, upon what principle of law does the conclusion rest?

It may very readily be that the Bankers made an arrangement with the Syndicate or with the Railway Company, or both, that as they acquired securities under their contract such securities would be turned over to the Syndicate, or to the Railway Company, and that the Bankers would accept in payment therefor specified securities of the Railway Company. Clearly, however, such an arrangement would not result in an assignment by the Bankers of all of their rights under the contract and an assumption by the assignee of all of the obligations imposed upon them thereby. And in the absence of such an assignment and of such an assumption, it is most earnestly and confidently contended that no justification exists for a finding to that effect.

If these Intervenors are to deprive the Railway Company of rights which, otherwise, it would have under existing conditions, because it assumed the obligations of the Bankers under the contract, do not they take up the burden of proving by affirmative and persuasive evidence that the conditions existed which alone will justify such a result? It seems to us that there can be but one answer to such inquiries and that, clearly, the record here does not contain facts such as will justify the conclusion that such a situation had been created. We do not enlarge upon the discussion, because we are unwilling to prolong this brief unnecessarily, and the proposition appears to us to be so wholly obvious.

Assuming, however, that the Court was correct in its assumption in this regard, there is left for consideration the correctness of its conclusions that the Railway Company is entitled to recover only $110,000, instead of the $250,000 which it advanced. The Court below substantially says that the transactions in question should be avoided because the Power Company was insolvent and they were had for the purpose of hindering, delaying and defrauding these Intervenors, yet it seeks to deprive the Railway Company of $140,000, because it holds that the Railway Company should, under the contract of September, 1911, have placed that sum in the treasury of the Power Company, and have taken therefor Second Mortgage bonds, which it holds were then worthless and known so to be by the parties to the transaction. Does not the mere statement of the proposition shock one's sense of equity?

Can it be justly held that these transactions were fraudulent as to the Intervenors because the Power Company was insolvent and in the same breath that the Railway Company will be held to its contract to purchase securities which, if such insolvency existed, were, as the Court finds, worth less? If they were worthless, the Power Company was unable to perform its contract, in that it was unable to deliver to the Railway Company anything of value; and under what principle of law shall a court of equity hold a party to the performance of a contract, when the entire consideration to be given by the other party has wholly and absolutely failed?

Fortunately, as we have before shown, we are not without authority to gainsay so unusual a proposition. Thus, in

Benedict v. Field, 16 N. Y., 595, a portion of the syllabus is as follows :

> " Upon an executory contract for the delivery of goods, sold for payment, upon such delivery, in the notes of a third party, who becomes insolvent between the time of the contract and that stipulated for its performance, *the seller is not bound to deliver upon a tender of notes, though they are not entirely worthless.*"

And, the Court, per Comstock, J., said :

> " The defendant was not bound to part with his property and accept in payment the notes of an insolvent firm, such insolvency having occurred, or at least having been ascertained, after the sale and before the time of delivery. * * * It is true that the sale, looking only at the precise letter of the contract, *was not defeasible in the event which occurred.* But when the parties contracted, the firm of Leggett Brothers was in good credit and was supposed to be solvent. Their notes were to be accepted as payment, but the ability of that firm to give good notes was assumed, and was really the consideration of the defendant's engagement to sell and deliver the goods. * * *
>
> " The analogies to be derived from the law of stoppage *in transitu* are perhaps not perfect, but they are, I think, sufficiently near to furnish a rule for the present case."

In *Bruce v. Burr*, 5 Daly (N. Y.), 510; aff'd 67 N. Y., 237, defendants, in consideration of the delivery to them of the note of a third party, agreed to sell and deliver to the plaintiffs certain books. *After a portion of the books had been delivered*, the defendants learned that the maker of the note was insolvent and they refused to make further deliveries. Held, that the consideration of the contract having failed, the defendants were justified in refusing to deliver. The General Term said :

> " The contract, though executed as to the goods already delivered, *was executory as to the goods there-*

after to be ordered. The consideration of said contract had entirely failed, and the defendants, *already at a loss on this account*, had a right to protect themselves against any further damage."

It is even held that, where the parties have executed the contract in mutual ignorance of facts which render the consideration valueless, equity will give a remedy on the ground of mutual mistake of fact. Thus, in *Harris v. Hanover National Bank*, 15 Fed., 786, the plaintiffs, who were the owners of a note of a New Orleans firm, sold the same, through note brokers, to the defendant in New York. An hour before the sale, an attachment, upon which their establishment was seized, was issued against the makers of the note by local creditors. Neither the defendant, nor the plaintiffs, nor the note brokers knew of the attachment at that time. The money received by the note brokers from the defendant having been paid into Court, it was held that the defendant might recover it.

The Court (Coxe, J.), said :

> " The almost unbroken line of authority seems to establish the doctrine that if bills of a broken bank, or the notes of a party who has previously failed, are transferred in payment of a debt, both parties being ignorant of the failure and innocent of fraud, the creditor may repudiate the payment, upon a tender or return of the dishonored note, and recover the amount due " (Citations). " It is true that in many of these cases the debased or worthless paper was given in payment of a pre-existing debt, while in the case at bar the delivery was the result of a bargain and sale. * * * Yet, upon an analysis of the reason upon which these decisions are based—viz., mutual mistake—it is not easy to discover any difference in principle."

To the same effect is *Roberts v. Fisher*, 43 N. Y., 159. There, defendants, being indebted to plaintiff for goods sold, gave him the note of a third person, which he received in full payment and discharge of the debt. The maker of the note was insolvent at the time, but this fact was not known to either the defendants or the plaintiff. Held, that the plaintiff

might recover from defendants his original claim against them. The Court, per PECKHAM, J., said :

> "Upon broad principles of justice, it would seem that a man should not be allowed to pay a debt with worthless paper, though both parties supposed it to be good."

That insolvency discharges the other party to a contract is also held in *Ex parte Chalmers*, L. R., 8 Ch., 289, where MELLISH, L. J., speaking for the court with reference to a sale to one who became insolvent after the contract was made, said :

> "I am of opinion that the result of the authorities is this : that in such a case the seller, *notwithstanding he may have agreed to allow credit for the goods, is not bound to deliver any more goods under the contract, until the price of the goods is tendered to him.*"
>
> See, also,
>
> *Thomas v. Westchester Co. Supervisors*, 115 N. Y., 47.
> *Stewart v. Orvis*, 47 How., Pr. (N. Y.), 519.

Most earnestly we submit, therefore, that under the conditions assumed by the learned Trial Court, both upon principle and authority, neither the Bankers, nor the Syndicate, nor the Railway Company, assuming the latter to have taken over the obligations of the Bankers thereunder, were, because of the contract of September, 1911, under any legal responsibility to purchase the additional $175,000 of second mortgage bonds and to pay therefor $140,000. Must it not follow, therefore, that, to the extent that the court below required the completion of the performance of that contract as a condition to any relief to the Railway Company, it imposed an obligation which the law would not have imposed and one which, accordingly, cannot be sustained?

The only alternative to the last-mentioned proposition is that the Power Company was not insolvent, that, accordingly, its second mortgage bonds were not worthless and, therefore, that the Bankers or the syndicate or the Railway Company were not relieved from completing performance of the contract. If that horn of the dilemma be taken by the Intervenors, does it not follow that everything which was done evidences an intention to continue the business of the Power Company? And if such be the case, who will say that the

parties to these transactions did not then consider the second mortgage bonds to possess substantial value? And if they possessed substantial value, or the parties then so believed, such value was a consideration for the contracts of September and December, 1912, in addition, in the case of the September contract, to the $250,000 advanced thereunder, and, in the case of the December contract, to the obligations from which the Power Company was relieved, the obligation assumed by the Railway Company to purchase $25,000 of Power Company second mortgage bonds, and the value, or assumed value, of the 50 shares of preferred and of the 100 shares of its common stock issued and delivered to Bates & Rogers Construction Company, in connection with the performance thereof. If such were the case, the final questions are merely those relating to sufficiency of consideration. And, in view of the then deficit in the Power Company's earnings, and its consequent inability to borrow elsewhere or to sell its bonds in the market, upon what principle of law or equity can it be concluded that the considerations received by the Power Company were so grossly inadequate as to shock the conscience.

We do not apologize for the length of the brief, because we consider of vast importance every case where men are charged with having committed fraud; in addition to which, the financial considerations here involved are sufficient to justify every possible effort on the part of counsel to aid the court in reaching correct conclusions. The brief has, however, been formulated under conditions of time and opportunity so restricted that it has been necessary to prepare it in great haste; and we are entirely sensible that, as a result, it lacks much of the orderly arrangement and coherency of discussion which should obtain in presenting one's written views to an appellate court. That result we regret sincerely, but time has left no alternative.

It is most earnestly submitted that the decree below, so far as it concerns the 718 bonds, should be reversed *in toto*, with costs to the appellants.

Respectfully submitted,

ELDON BISBEE,

Amicus Curiæ.

C.

In the last analysis, the last consideration is, of course, of no importance, because, if the company was not insolvent, it was competent to contract with the Railway Company in any manner which it saw fit, providing that the Railway Company in making the contract, had no intention of hindering, delaying and defrauding the intervenors.

As bearing upon the injustice of thus depriving the Railway Company of $140,000, we again call attention to the terms of the contract (intervenors Ex.3), authorized by the Executive Committee of the Power Company on September 27, 1912, which, after reciting that three of the parties thereto were also parties to the original contract or September 19, 1911, the performance thereof in certain respects, the fact that changed condition had rendered it advisable to substitute certain considerations for those originally contemplated by the parties, that the Bankers had, for a valuable consideration, "been released from their obligation to purchase said $175,000 face value of said bonds", and that "the Bankers have been required from various causes in connection with the transaction contemplated" by said contract September 1911" and have from time to time, advanced far more money than was originally contemplated" in said contract" and have otherwise assisted beyond contract obligations in carrying out the spirit of said" ~~xxxxx~~ contract. (pp.250-256).

It thus appears from the corporate records, authenticated by the controlling votes of the Messrs. Mainland, the intervenors witnesses, that the parties then conceded that, although the balance of the second mortgage bonds had not been purchased, as a matter of fact, the Bankers had advanced to the Company more money than originally contemplated and, otherwise, had gone beyond their contract obligation, in assisting the Company.